Supreme Court, U. S.
FILED
NOV 16 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-668

ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., *et al.*,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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November 10, 1977

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D.C. 20001

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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners, the Independent Insurance Agents of America, Inc., its constituent state associations and various individual member agencies in the States of Alabama and Georgia, request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in these cases.[1]

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[1] Petitioners herein were petitioners in the cases designated by the court of appeals as Docket Nos. 74-2981, 74-3544 and 74-3843. In those cases, the two bank holding company applicants and a committee of lender organizations intervened in support of the respondent Board of Governors of the Federal Reserve System.

OPINIONS BELOW

The court of appeals issued its first decision in these cases on June 10, 1976. That opinion is reported at 533 F.2d 224 (5th Cir. 1976), and appears at Appendix A hereof.

On January 10, 1977, the court of appeals issued a second decision which in part granted and in part denied petitions for rehearing filed by both sets of parties. That opinion was initially reported at 544 F.2d 1245 (5th Cir. 1977) (advance sheets), but was deleted from the bound volume of the *Federal Register* at the instruction of the court of appeals.[2]

Finally, on September 1, 1977, the court of appeals rendered a second rehearing decision granting the respondent's petition for further rehearing. That opinion is reported at 558 F.2d 729 (5th Cir. 1977), and appears at Appendix D hereof.

The judgment of the court of appeals appears at Appendix D hereof.

JURISDICTION

The jurisdiction of the court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Historically, there has existed in this country a rigid separation between banking and other forms of commerce. Such separation arises out of a concern on the part of Congress that the viability of banking organizations be carefully protected[3] and a recognition by Congress that the

[2] *See* 544 F.2d 1245 (Editor's Note).

[3] *See, e.g.*, H.R. Rep. No. 1747, 91st Cong., 2d Sess. 11-12 (quoting the President) (Conference Report), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5561, 5562.

power of banking organizations to control credit transactions provides them with a unique opportunity to influence borrowers in connection with purchases of nonbanking services.[4]

The principal statutory exception which permits banking organizations to participate in limited forms of commerce is Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended ("Act"). The manner in which this section is applied will determine whether the historical separation between banking and commerce will be preserved.[5]

The instant cases involve approval by the Board of Governors of the Federal Reserve System ("Board"), under Section 4(c)(8), of certain bank holding company applications for authority to act as agents and brokers in the sale of property and casualty insurance. In affirming the Board's orders, the court of appeals applied the statutory tests of Section 4(c)(8) in a manner which (i) conflicts with the holdings of the courts of appeals of other circuits, and (ii) contravenes the standards established by Congress to keep banking separate from other forms of commercial activity. The resolution of the issues presented by these cases will determine the future relationship between banking and commerce in the economy of this nation. As such, those issues deserve to be settled by this Court. The questions presented are:

1. Whether the "closely related" to banking test set forth in Section 4(c)(8) of the Act is so broad as to per-

[4] *See id.* at 18, [1970] U.S. Code Cong. & Ad. News 5569.

[5] This and other courts, on numerous occasions, have been called upon to restrain the administrative largesse of bank regulatory agencies in order to preserve the historical separation between banking and commerce. *See, e.g., Investment Co. Inst.* v. *Camp*, 401 U.S. 617 (1971); *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972); *Saxon* v. *Georgia Ass'n of Independent Ins. Agents*, 399 F.2d 1010 (5th Cir. 1968); *Port of New York Auth.* v. *Baker, Watts & Co.*, 392 F.2d 497 (D.C. Cir. 1968).

mit bank holding companies to engage in *any* nonbanking activity where there exists "any type connection between banking and the nonbanking activity in question which makes it rational to consider the proposed activity an 'incident' to banking" [6]—a standard which would permit the Board to add to its list of permissible nonbanking activities almost without limitation.

2. Whether the "public benefits" test set forth in Section 4(c)(8) of the Act is so devoid of substance as to permit approval of applications where (i) an applicant failed to make clear the procedures by which the nonbanking activity would be conducted; [7] (ii) the Board violated its own regulation making the price at which insurance is offered to the consumer an overriding consideration in property and casualty insurance agency applications; (iii) the Board "apparently assumed" that an applicant would operate the proposed nonbanking activity "not precisely as its witnesses suggested, but in a manner that will comply with [state] law"; [8] and (iv) the Board ignored evidence in the record that approval of the applications would result in most of the adverse effects enumerated in the Act, including the tying of sale of insurance to extensions of credit.[9]

STATUTE INVOLVED

The statute involved in these proceedings is the Bank Holding Company Act of 1956, as amended, 12 U.S.C. §§ 1841-50, 1871-78 (1970), and principally Section 4(c)(8) thereof, 12 U.S.C. § 1843(c)(8) (1970). The administrative regulation principally involved is Section 225.4(a)(9) of the Board's Regulation Y, 12 C.F.R. § 225.4

[6] Appendix A, at 31a (533 F.2d 224, 244).

[7] Appendix A, at 49a (533 F.2d at 253).

[8] Appendix A, at 49a, 51a (533 F.2d at 252, 253).

[9] *See* Appendix G, at 113a; Appendix H, at 138a.

(a)(9) (1977). Section 4(c)(8) of the Act and Section 225.4(a)(9) of the Board's Regulation Y appear at Appendix I hereof.

STATEMENT OF THE CASE

The bank regulatory legislation of this nation has long maintained a separation between banking and other forms of commerce. Since the establishment of the national banking system, Congress has prohibited federal banking associations from engaging in any activity which was not banking or an incidental power of banks.[10] When Congress enacted the Bank Holding Company Act and the 1970 amendments thereto, it continued and extended this principle.[11] Consequently, the Act generally prohibits bank holding companies from owning the shares of any company which is not a bank.[12] The limited exceptions to this prohibition are set out in Section 4 of the Act, with the principal exception contained in subsection (c)(8).[13] Section 4(c)(8) essentially provides that a bank holding company may engage in a nonbanking activity if, *and*

[10] *See* National Bank Act, ch. 106, § 8, 13 Stat. 101 (1864) (current version at 12 U.S.C. § 24 (Supp. V 1975)).

[11] S. Rep. No. 1084, 91st Cong., 2d Sess. 2-3, *reprinted in* [1970] U.S. Code Cong. & Ad. News 5520-21; S. Rep. No. 1095, 84th Cong., 1st Sess. 11-14 (1955).

[12] 12 U.S.C. § 1843(a) (1970). The 1970 amendments changed the law in several important ways. Most significantly, the Act for the first time applied to one-bank holding companies, whereas, prior to 1970, its application had been limited to multiple-bank holding companies. *See* S. Rep. No. 1084, 91st Cong., 2d Sess. 2, *reprinted in* [1970] U.S. Code Cong. & Ad. News, 5520-21. In addition, Section 4(c)(8) of the Act was modified essentially (i) to permit approvals of bank holding company applications without a formal hearing in certain instances not germane here, and (ii) to establish criteria for determining whether a particular activity is a "proper incident" to banking or managing or controlling banks. *Compare* 12 U.S.C. § 1843(c)(8) (1970) *with* 12 U.S.C. § 1843(c)(8) (Supp. III 1964).

[13] Appendix I (12 U.S.C. § 1843(c)(8) (1970)).

only if, it can make an affirmative showing that (i) the particular activity in which it wishes to participate is "closely related" to banking, and (ii) its participation in the activity can reasonably be expected to result in benefits to the public that outweigh possible adverse effects.[14]

In 1971, the Board promulgated Section 225.4(a)(9) of its Regulation Y, 12 C.F.R. § 225.4(a)(9) (1977), which purported to enumerate certain types of insurance agency activities it considered to be "closely related" to banking within the meaning of Section 4(c)(8) of the Act.[15] The Independent Insurance Agents of America, Inc. ("IIAA") and various of its state and local associations (collectively hereinafter referred to as the "IIAA parties") opposed certain bank holding company applications for insurance agency authority under the Board's regulation and requested that the applications be set for hearings.

In opposing the applications, the IIAA parties argued that Section 225.4(a)(9) failed to enumerate the precise activities which were allegedly "closely related" to banking or to explain why the Board determined that the necessary close relationship between such insurance activities and banking existed. The IIAA parties also argued that, even if the lines of insurance for which authority was being sought were "closely related" to banking, approval of the bank holding company applications could not reasonably be expected to result in benefits to the public that outweighed possible adverse effects.

Eventually, the Board announced that hearings would be held on 22 of the then pending applications designated FRB Docket Nos. IA-1 through IA-22.[16] The applications

[14] *Id.*

[15] *See id.* (12 C.F.R. § 225.4(a)(9) (1977)).

[16] *See* 38 Fed. Reg. 6,441 (1978).

of Southern Bancorporation ("Southern") and First National Holding Corp. ("First National") to which the instant cases relate were among the applications set for hearing.

In all, four separate hearings involving eight bank holding company insurance agency applications were held in the FRB Docket IA series of cases. The remainder of the 22 original applications were either withdrawn, settled by pretrial agreements among the parties that the results of the cases litigated would be binding on all parties, or delayed pending the final outcome of the cases which were tried.[17]

The Administrative Law Judge issued separate recommended decisions concerning the Southern and First National applications.[18] In those decisions, he determined that approval of the applications *could not* reasonably be expected to result in public benefits (such as greater convenience, gains in efficiency and increased competition). To the contrary, he found that approval of the applications would be more likely to produce decreased competition and the tying of insurance sales to extensions of

[17] In addition to the two cases at bar, five cases were tried in one consolidated hearing in the State of Florida. Since that trial, one of those applications has been rendered moot by the distress merger of the applicant (Palmer Bank Corporation) with Southeast Banking Corporation. *See* 40 Fed. Reg. 34,645 (1975).

Other Docket IA cases which have not been withdrawn involve bank holding companies from Arizona, California, Missouri, Virginia and Washington. Further, during the pendency of the instant cases, additional applications have been filed with the Board by bank holding companies from California, Colorado and Pennsylvania. The applicants in those cases have agreed with the Board that the applications not be processed pending final disposition of the instant cases.

[18] The Administrative Law Judge recommended decisions appear at Appendix G and Appendix H hereof.

credit, particularly in times of tight money.[19] Despite these findings, the Administrative Law Judge did recommend limited approvals of the applications.[20]

The Board reversed the factual determinations made by the Administrative Law Judge (in most instances with no reference to his contrary findings) and approved the applications in virtually all respects.[21] The IIAA parties filed petitions for review of the Board's orders with the United States Court of Appeals for the Fifth Circuit. In each case, the jurisdiction of that court rested upon Section 9 of the Act, 12 U.S.C. § 1848 (1970).[22]

The two cases were briefed separately, but were consolidated for argument. The court of appeals issued a single opinion on June 10, 1976. Petitions for rehearing were filed both by the IIAA parties and by the Board. The court issued its first rehearing decision on January 10, 1977. That decision in part vacated, in part modified, and in part affirmed the court's earlier decision. Thereafter, the Board petitioned the court for further rehearing. On September 1, 1977, the court issued its second rehearing decision, wherein it partly vacated its first rehearing decision, essentially returning the cases to the posture they had been in after the court's original June 10, 1976 decision.[23]

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[19] *See* Appendix G, at 113a; Appendix H, at 138a.

[20] The Administrative Law Judge essentially recommended that the applications be approved only with respect to those markets where the applicants' banking subsidiaries controlled 15 percent or less of total bank deposits. *See* Appendix G, at 114a; Appendix H, at 140a.

[21] The orders of the Board appear at Appendix E and Appendix F hereof. Such orders were originally reported at 39 Fed. Reg. 25,548 (1974) and 39 Fed. Reg. 33,411 (1974).

[22] *See* Appendix I hereof.

[23] *See* note 2 and accompanying text *supra*.

REASONS FOR GRANTING THE WRIT

A. These Cases Are Cases of First Impression for this Court

Banking institutions are economically unique organizations since they alone are permitted to accept demand deposits.[24] Bank holding companies are the largest and most formidable of banking organizations in that they alone are able to gather together under single ownership and control most of the diverse components of the financial industry.[25] Furthermore, the capital resources of bank holding companies are enormous—far greater than any of the nonbanking industries they have been permitted to enter under Section 4(c)(8) of the Act.[26]

The banks of this nation are the principal source of commercial credit and, as such, they are an essential component of the process of capital formation.[27] Their dominance of such a vital element of the economic process provides them with a unique opportunity to control where borrowers purchase nonbanking services sold in connection

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[24] *See* 12 U.S.C. § 24 (Supp. V 1975).

[25] For a list of the activities which, in the Board's view, are permissible nonbanking activities for bank holding companies, see Section 225.4(a) of Regulation Y, 12 C.F.R. § 225.4(a) (1977).

[26] For example, at the end of 1975, the 1,821 bank holding companies in the nation controlled 3,674 banks with commercial bank deposits ($527.5 billion) representing *67.1 percent* of total bank deposits. Further, the total assets of those companies ($661.3 billion) represented *68.1 percent* of total commercial bank assets. *Annual Statistical Digest, 1971-75*, Federal Reserve Board, Tables 89A at 277, 89B at 279. The foregoing figures represent a dramatic increase in bank holding company power since 1971 when holding companies controlled only 2,420 banks whose total deposits ($297 billion) represented 55.3 percent of total bank deposits and whose assets ($362.3 billion) represented 56.7 percent of total commercial bank assets. *Id.*, Table 89B at 279.

[27] *See United States* v. *Philadelphia Nat'l Bank*, 374 U.S. 321, 326-27 (1963).

with extensions of credit.[28] Thus, partly out of a recognition of the enormous resources of banking organizations, and partly out of a perception of the ability of banking organizations to control credit transactions, Congress has historically prohibited banking organizations from engaging in other forms of commerce.[29]

Section 4(c)(8) of the Act is the principal exception to the general prohibition against bank participation in nonbanking activities. For this reason, if the "closely related" to banking standard is interpreted broadly, bank holding companies could receive authority to engage in nonbanking activities almost without limitation.[30] Simi-

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[28] Congress has demonstrated great sensitivity to the ability banking organizations have to "tie" the sale of nonbanking services to extensions of credit. For example, the Conference Report associated the 1970 amendments to the Act states:

> Tie-ins occur where a customer is forced or induced to accept other products and services along with that product which he seeks. Such tie-ins may result from actual coercion by a seller or from a customer's realization that he stands a better chance of securing a scarce and important commodity (such as credit) by "volunteering" to accept other products or services rather than seeking them in the competitive market place. In either case, competition is adversely affected, as customers no longer purchase a product or service on its own economic merits.

H.R. Rep. No. 1747, 91st Cong., 2d Sess. 18 (Conference Report), *reprinted in* [1970] U.S. Code Cong. Ad. News 5569.

The Board has itself previously stated:

> [B]ecause of the inferior bargaining position of the debtor, he may be suscepitble to the loan officer's "suggestions" concerning choice of coverage, premium rates, insurer and agent. As a result, the debtor easily may receive the impression that his loan application may be more favorably considered if he follows such suggestions.

Hearings on S. 1754 Before the Subcomm. on Financial Institutions of the Senate Banking and Currency Comm., 91st Cong., 1st Sess. 163 (1969).

[29] *See, e.g.*, H.R. Rep. No. 387, 91st Cong., 1st Sess. 2 (1969).

[30] Bank holding companies have already been permitted to enter a substantial number of nonbanking activities, and the effect has been dramatic. *See* 12 C.F.R. § 225.4(a) (1977). For example, bank holding companies now control 34 of the 100 largest mortgage companies, 27 of the largest 86 noncaptive finance companies and 13 of the largest factoring companies in the country. *See* Talley, "Bank Holding Company Financing," *Conference on Bank Structure and Competition* (Federal Reserve Bank of Chicago), at 128 (1975). In fact, bank holding company penetration into the mortgage insurance industry has been so complete that a bank witness in these cases characterized the independent mortgage company as a "dead duck." *See* Transcript, vol. 3, at 423, *Application of Barnett Banks of Florida, Inc., etc.*, 40 Fed. Reg. 44,620, 44,624, 44,630 (1975) (FRB Docket Nos. IA 6, 7, 3, 12 & 13).

larly, if the "public benefits" standard of Section 4(c)(8) is interpreted expansively, bank holding companies could receive authorizations to engage in nonbanking activities even though, *as in the instant cases*, they fail even to enumerate the procedures by which the nonbanking activity will be conducted.[31] Only if the "closely related" and "public benefit" standards of Section 4(c)(8) are interpreted with the precision and care contemplated by the Act can the separation between banking and commerce be preserved. Similarly, only if the standards set forth in Section 4(c)(8) are interpreted in a way which makes them truly meaningful will the adverse effects upon the public recognized by Congress be avoided.

In its decision, the court of appeals articulated a standard for "closely related" activities that would permit the Board to expand its list of permissible nonbanking activities almost without limitations.[32] Furthermore, with regard to the "public benefits" test, the court sanctioned the

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[31] *See* notes 43-44 *infra* and accompanying text.

[32] *See* notes 35-38 *infra* and accompanying text. In this connection, it should be noted that currently there are 12 activities the Board has declared to be "closely related" activities. *See* 12 C.F.R. § 225.4(a) (1977). Bank holding companies may, however, file applications for authorization to engage in *any* activity which in their view is "closely related" to banking, *whether or not* the activity appears on the Board's current list of permissible activities.

Board's approval of future Section 4(c)(8) applications, even though the applicants have not committed themselves to "one or another mode of operation." [33] Consequently, these cases have significance well beyond the parties immediately involved—indeed, well beyond the property and casualty insurance industry as a whole. They represent precedent with respect to *all* nonbanking activities bank holding companies from time to time may seek to enter in the future. Since this Court has heretofore never passed upon the meaning of the standards set forth in Section 4(c)(8), this Court should intervene in these cases (i) to resolve the conflict that currently exists between the decision in these cases and previous decisions of other courts of appeals,[34] and (ii) to provide guidance as to the meaning of the "closely related" to banking and the "public benefits" standards of Section 4(c)(8) of the Act.

B. The Decision of the Court of Appeals Regarding the "Closely Related" Test Is in Conflict with a Prior Decision of the Court of Appeals of Another Circuit

The meaning of the "closely related" test was considered by the United States Court of Appeals for the District of Columbia Circuit in *National Courier Association* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1229 (D.C. Cir. 1975). At issue in that case was the validity of a Board regulation permitting bank holding companies to engage in certain courier services. In assessing the regulation, the court determined that at least the following relationships qualify as "closely related" under Section 4(c)(8):

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[33] Appendix A, at 50a (533 F.2d at 253). For a discussion of the significance of these and other relevant holdings of the court of appeals, see notes 39-44 *infra* and accompanying text.

[34] *See* notes 36-45 *infra* and accompanying text.

1. Banks generally have in fact provided the proposed services.

2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.

3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.[35]

The court of appeals in the instant cases specifically applied the *National Courier* test to the Board's regulation permitting the sale of property and casualty insurance and determined that such activity *did not* qualify as an activity which is "closely related" to banking under the *National Courier* standard.[36] Instead of determining that the sale of property and casualty insurance is therefore *not* "closely related" to banking, the court declared that it was "willing . . . to consider broader types of relationships." [37] Ultimately, the court stated that the Board should be upheld "when it articulates *any type connection* between banking and the nonbanking activity in question which makes it rational to consider the proposed activity an 'incident' to banking." [38]

This interpretation of the "closely related" standard is in clear conflict with the construction adopted by the Court of Appeals of the District of Columbia Circuit in the *National Courier* case.

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[35] 516 F.2d at 1237.

[36] Appendix A, at 23a-24a (533 F.2d 224, 241).

[37] Appendix A, at 24a (*id.*).

[38] Appendix A, at 31a (533 F.2d at 244) (emphasis added).

C. The Decision of the Court of Appeals Regarding the Application of the "Public Benefits" Test Is in Conflict with Prior Decisions of the Courts of Appeals of Other Circuits

Section 4(c)(8) of the Act states that, in determining whether a particular activity is a "proper incident" to banking, the Board shall consider whether the performance of the activity by the applicant can reasonably be expected to result in benefits to the public that outweigh possible adverse effects.[39]

The proper application of the "public benefits" test was considered by the United States Court of Appeals for the Eighth Circuit in *American Bancorporation, Inc.* v. *Board of Governors of the Federal Reserve System*, 509 F.2d 29 (8th Cir. 1974), and the United States Court of Appeals in the District of Columbia Circuit in *Independent Bankers Association of Georgia* v. *Board of Governors of the Federal Reserve System*, 516 F.2d 1206 (D.C. Cir. 1975).[40]

In *American Bancorporation*, the court stated that Section 4(c)(8) requires the Board to scrutinize bank holding

[39] There can be no doubt that Congress viewed the careful application of the "public benefits" test as a crucial element of the implementation of Section 4(c)(8) as amended in 1970. In promulgating the test, Congress made clear that a bank holding company seeking to engage in a nonbanking activity "must bear the burden of proof in showing that its carrying on of a particular nonbank activity would produce benefits to the public that outweigh any adverse effects." H.R. Rep. No. 1747, 91st Cong., 2d Sess. 19 (Conference Report), *reprinted in* [1970] U.S. Code Cong. & Ad. News 5570. In this connection, the Board is required to carefully scrutinize Section 4(c)(8) applications to assure that the entry into the activity "*in a given manner* would be in the public interest." *Id.* (quoting the Assistant Attorney General, Antitrust Division) (emphasis added).

[40] In both cases, the question before the courts was whether, under the facts presented, the Board was required by Section 4(c)(8) to hold adversary proceedings to determine whether approval of the applications would result in benefits to the public that outweighed possible adverse effects.

company applications "with great care" in order to determine the manner in which the applicant intends "to *operate, control*, and *benefit* from its prospective subsidiary." [41] The court in *Independent Bankers* held that the purpose of the hearing required by Section 4(c)(8) of the Act is "to discover *exactly* what the *specific facts of this particular proposal are.*" [42]

In contrast, the court of appeals in the instant cases found that one of the applications could be approved even though the record "made clear that the precise procedures by which insurance would be placed and applied for had not been clearly established by [the applicant]." [43] Incredibly, the court went on to issue a generalized invitation to future Section 4(c)(8) applicants, *as a matter of policy*, not to commit themselves during the application process to "*one or another mode of operation.*" [44]

The generalized invitation by the court for Section 4(c)(8) applicants not to commit themselves during the application process to "one or another mode of operation" is in conflict with the holdings of the Court of Appeals for both the Eighth and District of Columbia Circuits and abrogates the Board's responsibility under the Act to protect the public interest.

[41] 509 F.2d at 38 (emphasis added).

[42] 516 F.2d at 1222 (emphasis added). The court in *Independent Bankers* also said that "[t]he question of 'public benefits,' like the more common administrative standard of 'public convenience and necessity,' can be answered only by weighing *all* the facts." 516 F.2d at 1226 (emphasis in original).

[43] Appendix A, at 49a (533 F.2d at 253).

[44] Appendix A, at 50a (533 F.2d at 253) (emphasis added). Specifically, the court said:

> Indeed, in view of the difficult adjustments involved in entering a new business . . . it may be the wisest policy [for Section 4(c)(8) applicants] to resist an early total commitment to one or another mode of operation.

D. The Decision of the Court of Appeals Interprets the "Public Benefits" Test Out of Existence

1. *Arrogation of Decision Making.* Section 4(c)(8) requires bank holding company applicants to show that approval of their applications can reasonably be expected to result in benefits to the public, such as greater convenience, gains in efficiency and increased competition, that outweigh possible adverse effects.[45] In the instant cases, the Board determined that approval of the applications would result in all three of the foregoing public benefits.[46] The court, however, disagreed with the Board, striking down the Board's findings regarding both greater convenience and gains in efficiency.[47] In so doing, the court noted that the evidence suggested that the applicants' proposals might well result in *less* convenience and *reduced* efficiency.[48] Having determined that the Board erred in assessing the impact of the applications with regard to *two out of three* of the public benefits factors making up the overall public interest test, the court should have remanded the cases to the Board so that *the Board* could perform again the balancing process mandated by the Act.[49]

2. *Violation of State Law.* Section 7 of the Act, 12 U.S.C. § 1846 (1970), prohibits the Board from approv-

[45] *See* Appendix I (12 U.S.C. § 1843(c)(8) (1970)).

[46] *See* Appendix E, at 74a-75a and Appendix F, at 91a-93a.

[47] Appendix A, at 37a-41a (533 F.2d at 247-49).

[48] *Id.* Throughout these proceedings, the IIAA parties argued that any gains in efficiencies the applicants may have been able to show (and there were none) had no relevance as far as Section 4(c)(8) was concerned unless it could be shown that the fruits of such efficiencies could be passed on to consumers in the form of lower prices or improved services. Astonishingly, the court found that, under the Act, gains in efficiencies were relevant even though they resulted only in "better salaries or benefits to the provider's employees, or the availability of greater capital for expansion of the business." Appendix A, at 39a-40a n.21 (533 F.2d at 248 n.21).

[49] *SEC* v. *Chenery Corp.*, 318 U.S. 80, 88 (1943); *cf. United States* v. *Third National Bank*, 390 U.S. 171, 183-84 (1968).

ing any bank holding company application which would transgress state law.[50] The court in the instant cases conceded that a "strong argument" could be made that one of the insurance agency proposals would violate state insurance licensing statutes.[51] The court then found that the Board had ignored the state law issue entirely by making a factual determination regarding how the applicant would operate its insurance agency "which seems to have little support from [the applicant's] own witnesses."[52] Despite this glaring deficiency in the Board's decision, the court upheld the Board in its "apparent assumption that [the applicant] will operate *not precisely as its witnesses suggested*, but in a manner that will comply with [state] law."[53] Such a holding constitutes clear reversible error.[54]

3. *The Board Violated Its Own Regulation.* When the Board announced the promulgation of Section 225.4(a)(9), it made the price at which insurance is offered under the regulation an overriding consideration in determining whether approval of an application will be in the public interest. Specifically, the Board

> "[e]xpressed the expectation that any holding company or subsidiary that acts as an insurance agency on the basis of the new regulatory provision will exercise a *fiduciary responsibility*—that is, by making its best efforts to obtain the insurance at the lowest practicable cost to the customer."[55]

[50] *See* Appendix I; *Whitney Nat'l Bank* v. *Bank of New Orleans & Trust Co.*, 379 U.S. 411, 424-25 (1965).

[51] Appendix A, at 49a (533 F.2d at 252).

[52] Appendix A, at 49a (*id.* at 253).

[53] Appendix A, at 51a (*id.*) (emphasis added).

[54] *Universal Camera Corp.* v. *NLRB*, 340 U.S. 474, 488 (1951); 12 U.S.C. §§ 1843(c)(8), 1848 (1970); *see NLRB* v. *Columbian Enameling & Stamping Co.*, 306 U.S. 292, 299-300 (1939); 12 U.S.C. § 1850 (1970).

[55] 36 Fed. Reg. 15,525, 15,526 (1971) (emphasis added). It should be noted that in this respect Section 225.5(a)(9) is consistent with

In the instant cases, it was established that "direct billed" insurance policies carry a lower price to consumers than identical policies where the billing is performed by insurance agents.[56] Neither of the applicants stated that it would offer "direct billed" insurance policies.[57] Since (i) the Board's regulation makes the price at which insurance is offered to the consumer an overriding consideration in property and casualty insurance agency applications, and (ii) the applicants in the instant cases did *not* intend to offer insurance "at the lowest practicable cost to [their] customer[s]," the approval of both applications was in violation of Section 225.4(a)(9).[58] For this reason, the court of appeals should have reversed the Board's orders and its failure to do so constitutes reversible error.[59]

4. *The Court Ignored the Record.* As noted previously, the court struck down the Board's findings regarding the greater convenience and gains in efficiency factors of the "public benefits" test. The court took such action, at least in part, because the Board had failed to recognize that the Administrative Law Judge had arrived at *exactly opposite*

Section 225.4(a)(10) of the Board's Regulation Y wherein the projection of reduced rates is enumerated as a key factor in determining whether approval of bank holding company applications to underwrite credit life and credit disability insurance will be in the public interest. *See* 12 C.F.R. § 225.4(a)(10) n.8 (1977).

[56] *See* Appendix A, at 39a (533 F.2d at 248). "Direct billed" policies are personal lines insurance policies which are issued, billed and renewed by the insurance companies rather than retail insurance agents. Since insurance agents are required to perform fewer administrative tasks with respect to these policies, such agents receive lower commissions and the policies can be offered at lower premiums to consumers.

[57] *Id.*

[58] The practical effect of the applicants' proposals is that consumers who purchase insurance from the applicants will pay *higher* prices than are otherwise available through nonaffiliated insurance agencies.

[59] *United States* v. *Nixon*, 418 U.S. 683, 696 (1974); *Service* v. *Dulles*, 354 U.S. 363, 388-89 (1957).

conclusions from its own and because the Board had made no effort to explain its departure from the Administrative Law Judge's findings.[60] Regarding the increased competition factor of the test, the court stated that there existed "no unexplained conflict" between the decisions of the Board and those of the Administrative Law Judge.[61] Such conclusion simply is *not* supported by the record.

In one case the Administrative Law Judge found that, in locations where the applicant's banking subsidiaries controlled substantial deposits, independent insurance agents would be subjected to "destructive competition."[62] He also found that, where large banking institutions are permitted to compete against "mostly small [insurance agents] . . . it is possible, even probable, that the Mom and Pop agency will be driven into merger or out of business entirely . . . ."[63] In the other case, the Administrative Law Judge found that, in markets where insurance agents are forced to compete with "double-barrelled financial conglomerate[s] . . . the independent agents would have difficulty surviving."[64] He also found that "the clientele [of large bank holding companies] that could possibly be subtly influenced to divert [insurance business away] from Atlanta independent agents is so large that many of the latter could be driven out of business or forced to merge into larger units resulting in decreased competitions."[65]

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[60] *See* Appendix A, at 38a-39a, 40a-41a (533 F.2d at 248, 249).

[61] Appendix A, at 41a (*id.* at 249).

[62] Appendix G, at 113a.

[63] *Id.* In the instant cases, it was not disputed that, "in general, [the insurance agency business is] quite inconcentrated and one in which entry barriers are low." Appendix A, at 47a (533 F.2d at 251).

[64] Appendix H, at 138a-39a.

[65] *Id.* at 138a. It is important to emphasize that, in *both* of the instant cases, the Administrative Law Judge found that at least "voluntary" tying of sales of insurance to extensions of credit would be a likely result of approval of the applications. *See* Appendix G,

Consequently, as in the case of the greater convenience and gains in efficiency factors of the test, there *does* exist an "unexplained conflict" between the findings of the Board and the finding of the Administrative Law Judge regarding increased competition. For that reason, as in the case of the other two factors, the court should have rejected the Board's findings concerning increased competition and reversed the Board's orders approving the applications. Its failure to do so constitutes reversible error.

5. *The Board's Decisions Were Not Supported By Substantial Evidence.* Section 9 of the Act requires that the evidentiary findings of the Board in Section (4)(c)(8) proceedings be supported by "substantial evidence."[66] As previously noted, the court invalidated the Board's findings regarding greater convenience and gains in efficiency on the grounds that they were not supported by substantial evidence. Regarding the only remaining public benefits factor, increased competition, the court stated that, "[w]hile the evidence [supporting the Board's conclusion] on this issue certainly can be described as *vague*, . . . it is enough."[67] This holding squarely presents the question of whether evidence which is merely "vague" can ever afford "a substantial basis of fact from which the fact in issue can be reasonably inferred."[68] The IIAA parties submit that it cannot.

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at 113a; Appendix H, at 137a-38a. The Board's rejection of those findings must be considered suspect in light of its previous acknowledgement that the "inferior bargaining position of the debtor" may "*easily*" permit him to "receive the impression that his loan application may be more favorably considered if he follows [the loan officer's] suggestions." *See* note 28 *supra*.

[66] *See* Appendix I (12 U.S.C. § 1848 (1970)).

[67] Appendix A, at 41a-42a (533 F.2d at 249) (emphasis added).

[68] *NLRB* v. *Columbian Enameling & Stamping Co.*, 306 U.S. 292, 299 (1939).

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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November 10, 1977

Appendices

APPENDIX A

Opinion of the United States Court of Appeals for the Fifth Circuit

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UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Nos. 74-2981, 74-3544 and 74-3843

ALABAMA ASSOCIATION OF INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

GEORGIA ASSOCIATION OF
INDEPENDENT INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

NATIONAL ASSOCIATION OF INSURANCE AGENTS, INC.,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

June 10, 1976

Petitions for Review of Orders of the Board of Governors of the Federal Reserve System (Alabama, Georgia and Georgia Cases respectively).

Before TUTTLE, THORNBERRY and CLARK, Circuit Judges.

THORNBERRY, Circuit Judge:

These consolidated petitions for review of orders by the Board of Governors of the Federal Reserve System represent the culmination of a four year campaign by Southern Bancorporation (Southern) of Birmingham, Alabama, and First National Holding Corporation (First National) of Atlanta, Georgia, to gain entry into certain aspects of the insurance agency business. From a broader perspective, they represent only one of many episodes in a huge commercial tug-of-war between the bank holding company industry on one hand and independent insurance agents and other insurance industry groups on the other. This struggle has taken place not only in the courts, but in the Congress and before the Federal Reserve System Board of Governors as well. After carefully considering the efforts and accomplishments of the contending parties before those bodies and the arguments advanced by the able counsel in this case, we find that substantial ground has been gained by the bank holding companies. We uphold for the most part the Board of Governors' action in granting Southern and First National permission to act as agent with respect to specified types of insurance and leave further struggle between insurance agents and these holding companies in the specified areas to the marketplace.[1]

[1] We note, however, that the legislative struggle continues even in the matters involved in this case. The "Competition in Banking Act of 1975", (S. 2721) presently pending in Congress, would impose greater restrictions on bank holding company activities in non-banking areas than presently apply. *See* BNA Antitrust & Trade Reg. Rep. No. 754, at A-14 (Mar. 9, 1976).

I. Legislative and Procedural Background

While recognizing that the protection of savings and the extension of credit are useful and even essential to our economic wellbeing, we as a nation have often been distrustful of the concentrated economic power that may accrue to the organizations that provide those services. This feeling has not been left at large in the streets, the factories, and the small businesses of the land, but has been written into the law by Congress; the Bank Holding Company Act, 12 U.S.C. § 1841 *et seq.* is an expression of that sentiment.[2] In passing the Act in 1956, Congress sought both to limit the concentration of banking resources and to implement a policy that "bank holding companies ought not to manage or control nonbanking assets having no close relationship to banking." Sen.Rep. No. 84-1095, 84th Cong., 1st Sess. (1956), 1956 U.S.Code & Adm.News at p. 2482. In furtherance of the latter objective, acquisition by holding companies of non-banking enterprises was prospectively forbidden. 12 U.S.C. § 1843(a) (1970). But a very important exception to the general prohibition was included: it remained acceptable to acquire companies "of a financial, fiduciary, or insurance nature . . . which the [Federal Reserve] Board . . . has determined to be so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto . . ." § 4(c)(8) of the Bank Holding Company Act of 1956, 12 U.S.C. § 1843(c)(8) (1970).[3]

[2] Having had experience with holding companies in other areas of commerce, Congress knew of the potential of such entities to multiply by many times the degree of concentration within an industry and to introduce unhealthy competitive practices in different but related industries. *See, e.g.*, 15 U.S.C. § 79 *et seq.* (1970) (Public Utility Holding Company Act).

[3] The statutory provision referred to was § 4(c)(6) of the Act as passed in 1956. A 1966 amendment resulted in its renumbering.

Pursuant to this provision, the Federal Reserve System Board of Governors (hereinafter the Board) in the late 1950's and 1960's granted many individual applications by holding companies to engage in nonbanking activities, including the sale of insurance. And when amendments to the Act were discussed in the late 1960's, there was significant sentiment for broadening the Board's discretion in the area. Whether the proponents of liberalization succeeded will be dealt with hereinafter; but it is clear that the Holding Company Act Amendments passed in 1970 contained several changes of significance in this case. First, Congress permitted the Board to make the determination whether particular lines of business were closely related to banking and thus within the § 4(c)(8) exception by general regulation, as well as by order in individual cases. Second, the limitation of such activities to those "of a financial, fiduciary, or insurance nature" was deleted. Third, Congress manifested unhappiness with the language requiring § 4(c)(8) activities to be "closely related to the business of banking"; it required in 1970 only that the business be "closely related to banking". Fourth, the Board was permitted to "differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern." Finally, and most significantly, a "public benefits test" was added to the criteria under § 4(c)(8); it provides that:

> [I]n determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices.

The Federal Reserve Board was not slow to use its new power to issue § 4(c)(8) regulations. After rulemaking proceedings in 1971, in which petitioner National Association of Insurance Agents (NAIA) participated, the Board promulgated § 225.4(a) of Regulation Y, which lists several nonbanking activities deemed sufficiently related to banking to satisfy the requirements of § 4(c)(8). Those relating to the insurance industry and to this appeal are set out in § 225.4(a)(9):

> (a) . . . The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto: . . .
>
> (9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:
>
> (i) Any insurance for the holding company and its subsidiaries;
>
> (ii) Any insurance that (*a*) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (*b*) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (*c*) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(*c*) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);
> (iii) Any insurance sold in a community that (*a*) has a population not exceeding 5,000, or

(*b*) the holding company demonstrates has inadequate insurance agency facilities.

12 C.F.R. § 225.4(a)(9) (1976).

No judicial review of this regulation was immediately sought. On September 6, 1972, the Board issued a regulation indicating its views as to the operative meaning of § 225.4(a)(9) in several particulars. § 225.228 of Regulation Y, 12 C.F.R. § 225.228 (1976). NAIA sought review of that regulation in the Court of Appeals for the District of Columbia Circuit, but that court dismissed the petition, holding that the regulation was merely interpretive and did not have the force of law. Because the issues thereby raised could be litigated in connection with specific applications under the Act, the court found the petition premature. *National Ass'n of Ins. Agents, Inc.* v. *Board of Governors of Federal Reserve System*, 160 U.S.App.D.C. 144, 489 F.2d 1268 (1974).

Among the flurry of applications for permission to engage in nonbanking activities which followed the adoption of § 225.4(a) of Regulation Y were those of Southern Bancorporation and First National Holding Corporation. They were submitted separately in February of 1972, but sought authority to sell, through subsidiaries, many of the same types of insurance. Some of the lines, such as credit life, credit health and accident insurance, and mortgage redemption insurance are not in issue here. The applications to sell other types of insurance were and are hotly contested. In this category are property damage insurance on assets being financed by banks owned by the holding company, liability insurance for borrowers from such banks, and "convenience" insurance as defined in Regulation Y.

The insurance industry parties in this case immediately expressed their opposition to the Southern and First National applications. After more than a year of preparation and preliminary skirmishing, the applications were considered consecutively at hearings before Administrative Law Judge Paul N. Pfeiffer in June, 1973. In early 1974, Judge Pfeiffer announced his findings and recommended decision: although the insurance activities proposed by Southern and First National were within the "closely related" standard of § 4(c)(8), as reasonably interpreted by the Board in its regulation, the holding companies had failed to meet the "public benefits" test added to the Act in 1970 (as to all but proprietary insurance for the holding company and its subsidiaries, and credit life, credit health and accident, and mortgage redemption insurance). In particular, the Administrative Law Judge found that there did not appear to be a reasonable expectation of substantial increased convenience to the public, that there was no basis for an expectation of operating economies which might be passed on to the consumer, that there were possibilities of unfair competition in the sale of insurance through "voluntary tying" of insurance purchases to bank loans; that the market power of each holding company was such that it could divert certain captive clientele of the banks from existing independent insurance agencies; and that sales of surety bonds could involve the holding companies in conflicts of interest.

The holding companies were down, but by no means out. They pressed their claims vigorously before the Federal Reserve Board and, in July and September of 1974, the Board responded favorably. In its orders, the Board noted its previous determination in § 225.4(a)(9) that certain insurance activities were permissible within the meaning of § 4(c)(8) of the Bank Holding Company Act. It adhered to that determination and found that, with minor exceptions,[4] the applications by Southern and First

[4] The Board excluded authorization for the sale of use and occupancy insurance, and business interruption and fidelity insurance

National were within the regulation. The Board generally accepted the basic factual findings of the Administrative Law Judge, but drew almost directly opposite conclusions from them. It concluded that it was reasonable to expect that the proposed activities would likely produce benefits to the public in convenience, efficiency, and increased competition, and that there was no danger of undue concentration of resources, no likelihood of conflicts of interest, and no evidence that there would be unfair competition in the form of coercive or voluntary tying of loans and insurance purchases. Accordingly, both Southern and First National were given permission to act as broker with respect to all of the lines of insurance presently in dispute.

II. Parties

The petition for review in No. 74-2981 was brought by the National Association of Insurance Agents, the Alabama Association of Insurance Agents, the Birmingham Association of Insurance Agents, and several individual insurance agencies. NAIA also is a petitioner in No. 74-3544, along with the Georgia Association of Independent Insurance Agents and several individual agencies. Together the 74-2981 and 74-3544 petitioners shall be referred to hereinafter as "the NAIA parties". All petitioners are or represent individual insurance agencies which are primarily small businesses selling insurance policies issued by more than one underwriter.

Southern Bancorporation (formerly known as The Alabama Financial Group, Inc.) is a bank holding company headquartered in Birmingham, Alabama. Its primary business is banking and it has subsidiaries in that business operating in twelve Alabama cities. Several of these subsidiaries have more than one banking office; the Birmingham Trust National Bank has over twenty. Southern

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because of lack of evidence. After a petition for review was filed in the Alabama case, the Board rescinded its authorization of the sale of mortgage guaranty insurance without Southern's objection.

also has three nonbanking subsidiaries: AFG Data Services, Inc., Alabama Financial Leasing, Inc., and Southern State Life Insurance Co.

Southern is the third largest bank holding company in Alabama, controlling approximately ten per cent of all commercial bank deposits in the state. It controls about twenty-two per cent of bank deposits in the Birmingham metropolitan area and nearly half of deposits in the Dothan metropolitan area and in Marion County. With the other four largest bank holding companies in Alabama, Southern controls approximately seventy-five per cent of commercial bank deposits in the state.

First National Holding Corporation, unlike Southern, is a one-bank holding company.[5] Its banking subsidiary, First National Bank of Atlanta, has over forty offices in two counties of the Atlanta metropolitan area. It is the second largest bank in the area, with about twenty-five per cent of all bank deposits. The holding company also has 162 subsidiaries engaged in various business and financial endeavors in Georgia and neighboring states. The most important of these for our purposes is Tharpe & Brooks, Inc., a wholly owned subsidiary which is in the mortgage banking business. Unlike Southern, which proposes to establisl. a new insurance agency to carry on the activities, First National plans to conduct its insurance activities through First South Insurance Agency, a Tharpe & Brooks subsidiary.

A. *Jurisdiction to Review*

The jurisdiction of this court derives from 12 U.S.C. § 1848, which authorizes review of a Federal Reserve Board "order" at the instance of a person thereby aggrieved. On the basis of the wording of this provision,

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[5] As such, First National was not subject to the Bank Holding Company Act until the passage of the 1970 Amendments.

the Board asserts that we lack power to review § 225.4 (a) (9) of Regulation Y, which was promulgated in 1971 and not challenged at that time. The Board correctly notes that there are significant legal differences between orders and regulations, and argues that the finality of a great number of Board orders under the regulation would be cast in doubt if review of the regulation were permitted at this time.

We disagree with the Board and find that it is our duty to review not only these orders, but the regulations upon which they are partially based. For one thing, the courts have held that a statutory provision for review of orders permits review of regulations, even standing alone, where the issues are primarily legal rather than factual, and there is an adequate record for review. *See Deutsche Lufthansa Aktiengesellischaft* v. *CAB*, 156 U.S.App.D.C. 191, 479 F.2d 912 (1973); *City of Chicago* v. *FPC*, 147 U.S. App.D.C. 312, 458 F.2d 731 (1971), *cert. denied*, 405 U.S. 1074, 92 S.Ct. 1495, 31 L.Ed.2d 808 (1972). *See also Pacific Gas & Elec. Co.* v. *FPC*, 164 U.S.App.D.C. 371, 506 F.2d 33, 47-48 (1974). This principle was illustrated in the recent decision in *National Courier Ass'n* v. *Board of Governors of Federal Reserve System*, 170 U.S.App.D.C. 301, 516 F.2d 1229 (1975) (*Couriers*), in which the court reviewed amendments to § 225.4(a) of Regulation Y under the jurisdictional provision for review of "orders" invoked here. The case before us arguably fulfills the applicable criteria, since the issues are primarily legal—whether the activities listed in the regulation meet the statutory "closely related" test—and there is factual material concerning the relationship of these activities to banking in the voluminous record compiled in these proceedings.

More importantly, we believe that even belated review of these regulations should not be foreclosed in the circumstances of this case. We deal here with orders that

involve two basic issues concerning the holding company applications: whether they meet the "closely related" test and whether they meet the "public benefits" test. The latter, by its nature, may be conclusively resolved only in the context of specific applications,[6] *Independent Bankers Ass'n of Georgia* v. *Board of Governors of Federal Reserve System*, 170 U.S.App.D.C. 278, 516 F.2d 1206, 1215-16 (1975); *American Bancorp., Inc.* v. *Board of Governors of Federal Reserve System*, 509 F.2d 29, 38-39 (8 Cir. 1974), while the former can be resolved either on an individual basis or by regulation. *See* 12 U.S.C. § 1843(c)(8).

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[6] The Board of Governors, in the Georgia case, stated that "in adopting the Insurance Regulation, [it had] found that the performance by bank holding companies of those activities authorized by such Regulation satisfied, in general, this public benefits test." IV Consolidated Joint Appendix 736 (hereinafter "App."). The NAIA parties argue that this indicates that the Board shifted the burden on the issue of net public benefits from the proposed activities from the applicant to the petitioners.

We agree that such a shift in the burden of proof by the Board would be error. *See* Conf. Rep. No. 91-1747, 91st Cong., 2d Sess., (1970) (Statement of the Managers on the Part of the House, hereinafter referred to as "Conference Report"), 1970 U.S.Code Cong. & Adm.News at p. 5570. The variables which Congress named as relevant to the public benefits determination are necessarily dependent upon local industry and market structures, upon the particular applications, and upon other factors which will vary widely in individual instances. While it may or may not be true that the Board makes a "general" public benefits determination in promulgating regulations on the "closely related" issue, *see* note 19 *infra*, any such determination should have no effect on the individualized inquiry which the Board must make in ruling on specific applications.

We find no indication, however, that the Board did shift the burden of proof to petitioners. Instead, the Board recognized that the public benefits determination required in connection with the specific applications was in addition to any general determination. IV App. 736. There is nothing in either of the Board's orders that has been cited to us or that we have found which indicates that the Board did not act on its apparent belief that the individual public benefits determinations were to be *additional to and separate from* the generalized findings embodied in § 225.4(a)(9).

Although the Board's decision to proceed by regulation was clearly proper, we note that its effect is not merely to narrow the area of contention between the parties on the "closely related" question, but in some respects to *conclude* that question in favor of the applicants.[7]

In light of the determinative effect of the regulation on some issues involved in the promulgation of these orders, it would be an "empty and useless thing" to review them without scrutiny of the regulation as well. *Doe* v. *CAB*, 356 F.2d 699, 701 (10 Cir. 1966), *quoted in International Harvester Co.* v. *Ruckelshaus*, 155 U.S.App.D.C. 411, 478 F.2d 615 (1973). We would partially abdicate our judicial duty if we were to allow the time limit for direct review to insulate forever this regulation, which has never been judicially tested, from scrutiny as to its consistency with Congressional mandate, all the while "reviewing" orders based, in significant part, wholly and directly upon it. Perhaps more importantly, that course would be unjust to many of the petitioning parties. It may be fair to say that NAIA, which participated in the rulemaking proceedings in 1971, had a chance to challenge this regulation within thirty days of its promulgation.[8] But is it fair to

[7] This is true, for example, of the "convenience" insurance authorized by § 225.4(a)(9)(ii)(c). Since the applications virtually track the language of this rather vague authorization, refusal to review the regulation would be tantamount to approval of the application on this point.

[8] It also may *not* be fair, in view of the fact that NAIA sought to raise many of these issues promptly upon the promulgation in September, 1972, of a regulation interpreting § 225.4(a)(9) of Regulation Y, 12 C.F.R. § 225.228. The Board in response strenuously and successfully argued that review of those regulations was at that time *premature*, since the issues could be raised in proceedings like this one! *National Ass'n of Ins. Agents, Inc.* v. *Board of Governors of Federal Reserve System*, 160 U.S.App.D.C. 144, 489 F.2d 1268 (1974).

We note also that considerations of concreteness and ripeness counsel that organizations like NAIA be permitted to wait until

say the same thing of petitioner, R. A. Brown Insurance Agency, Inc., in Alabama, or Morris-Fallaize Insurance, Inc., in Georgia, which may bear the economic detriments potentially arising from these applications? We believe not and find that, considerations of finality notwithstanding, our duty to see that the Congressional mandate in § 4(c)(8) is carried out in the individual cases which come before us requires review of § 225.4(a)(9) of Regulation Y. *See Oljato Chapter of Navajo Tribe* v. *Train*, 169 U.S.App.D.C. 195, 515 F.2d 654, 659 & n. 6 (1975); *Functional Music Inc.* v. *FCC*, 107 U.S.App.D.C. 34, 274 F.2d 543 (1958), *cert. denied*, 361 U.S. 813, 80 S.Ct. 50, 4 L.Ed.2d 81 (1959).

B. *Procedural Validity*

We pass then to the question of whether the regulation complied with the requirement of the Administrative Procedure Act that

> the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.

5 U.S.C. § 553(c) (1970). In this case, the regulation contained nothing that might be thought to respond to this statutory command other than the statement that

> [t]he following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto.

This statement does no more than conclusorily announce the import of the regulation. It does nothing to illuminate

specific cases applying regulations arise before seeking review. In that way, courts like this one are presented with a more adequate record and more information as to the full ramifications of the regulations, and with argument by adversary parties other than the promulgating agency. All of these factors aid the court in reaching an informed decision. *See* K. Davis, Administrative Law Treatise § 21.01 (1958).

the process by which the Board arrived at the regulation and accordingly is of little use in fulfilling the purposes of the statute, the facilitation of judicial review. *See Amoco Oil Co.* v. *EPA*, 163 U.S.App.D.C. 162, 501 F.2d 722 (1974); *Automotive Parts & Accessories Ass'n* v. *Boyd*, 132 U.S.App.D.C. 200, 407 F.2d 330 (1968); *National Resources Defense Council, Inc.* v. *SEC*, 389 F.Supp. 689 (D.D.C. 1974). The APA provision "does not require the agency to supply specific and detailed findings and conclusions of the kind customarily associated with formal proceedings", but this limitation "does not lessen or excuse the agency's obligation to publish a statement of reasons that will be sufficiently detailed to permit judicial review." *National Nutritional Foods Ass'n* v. *Weinberger*, 512 F.2d 688, 701 (2 Cir. 1975).

This statutory requirement, however, has not been enforced with the vigor that would, at first blush, seem indicated. Statements with no more informative content than the one before us have been held to pass muster. *Automotive Parts & Accessories Ass'n* v. *Boyd, supra; New York Freight Forw'rs & Brokers Ass'n* v. *Federal Maritime Comm'n*, 337 F.2d 289 (2 Cir. 1964), *cert. denied*, 380 U.S. 910, 85 S.Ct. 893, 13 L.Ed.2d 797 (1965). And regulations with no statement of basis and purpose at all have been upheld where the court deemed the basis and purpose obvious. *Hoving Corp.* v. *FTC*, 290 F.2d 803 (2 Cir. 1961).

The rationale of these decisions is not difficult to ascertain. Courts must have an adequate basis to engage in judicial review, but, as partners with the agencies in the effectuation of Congressional will through the administrative process, they do not function to strike down agency action because of merely formal or technical flaws. *Greater Boston Tel. Corp.* v. *FCC*, 143 U.S.App.D.C. 383, 444 F.2d 841, 851 (1970), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed.2d 701 (1971); *Braniff Airways* v. *CAB*, 126

U.S.App.D.C. 399, 379 F.2d 453, 465-68 (1967). For this reason, a court must not only examine whether an agency's promulgation of a challenged regulation complies with the procedural requirement; it must also determine whether, in light of the nature and content of the regulation and of the underlying legislation, the extraneous material which may be available to explain the basis and purpose of the agency action, and the quantum of action taken in reliance on the regulation, any procedural flaw so subverts the process of judicial review that invalidation of the regulation is warranted.

We find that this case is one in which we can "discern the path" of the Board with sufficient confidence. *See Environmental Defense Fund, Inc.* v. *EPA*, 167 U.S.App. D.C. 71, 510 F.2d 1292, 1304 (1975), *quoting Greater Boston Television Corp.* v. *FCC*, 143 U.S.App.D.C. 383, 444 F.2d 841, 851 (1970), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed.2d 701 (1971). The regulation at issue is not one which purports to carry out a vague statutory command through prescription of detailed standards of conduct, or sets out a complex method of proceeding in order to receive some type of agency approval. *Cf. National Ornament & Elec. Light Christmas Ass'n, Inc.* v. *Consumer Product Safety Comm.*, 526 F.2d 1368, 1371-72 (2 Cir. 1975). To the contrary, the regulation makes a single and limited factual and legal determination: that certain insurance activities are so "closely related" to banking as to be proper incidents thereto. For this reason, it is not necessary for the agency to explain what the *purpose* of the regulation is; it obviously is intended to facilitate the process of applying for holding company authority to engage in nonbanking activities while authorizing only such activities as are permissible under the "closely related" standard.

The *basis* for the agency's designation of these particular activities as permissible is less clear. But to aid us

in divining it we have not only the detailed briefs of the several parties and *amici*, the pre-1970 decisions of the Board on applications to engage in insurance activities,[9] and the legislative history of the 1956 Act and the 1970 Amendments, but also the extensive record in the hearings before the Administrative Law Judge in these cases. *Cf. Automobile Parts & Accessories Ass'n* v. *Boyd, supra* at 338 (court may consider statement of agency in denying rehearing); *Environmental Defense Fund* v. *EPA*, 167 U.S.App.D.C. 71, 510 F.2d 1292, 1304 & n. 40 (1975) (resort to detailed factual record is permissible in lieu of complete findings in hearing contest). Admittedly, much of the record is not relevant to the Board's reasoning on the "closely related" issue and that portion which is relevant is "after the fact" explication of which we have every right to be suspicious. *See Rodway* v. *Department of Agriculture*, 168 U.S.App.D.C. 387, 514 F.2d 809, 816-17 (1975). But we find that there is enough here, in light of the limited nature of the regulation and the impact of its wholesale invalidation for non-substantive flaws, that we can "see whether the agency, given an essentially legislative task to perform, has carried it out in a manner calculated to negate the dangers of arbitrariness and irrationality." *Automotive Parts & Accessories Ass'n* v. *Boyd, supra* at 338.

C. *Substantive Challenges*

The NAIA parties generally argue that the activities listed in § 225.4(a)(9) of Regulation Y violate § 4(c)(8) of the Bank Holding Company Act in that they are not sufficiently "closely related to banking." Although their efforts are directed most vigorously toward the portion of the regulation which the Board has relied upon in authorizing the sale of property and liability insurance

[9] The Board ruled on 27 applications to engage in insurance activities during this period.

in these orders, we find that the very general language of the regulation on that subject is permissible. Other portions, however, authorize the sale of insurance that is so clearly unrelated to banking that they must fall.

As the Board recognizes, the "closely related" standard imposes definite limits upon its discretion to permit nonbanking activities by bank holding companies. Accordingly, the Board rejected applications to engage in some insurance activities, even before the 1970 Amendments.[10] However, the great majority of pre-1970 insurance applications were approved by the Board, and these constituted most of the nonbanking activities authorized under § 4(c)(8) prior to 1970. Among the specific types of activities authorized were insurance for the holding company and its employees, comprehensive property insurance, and renewal of insurance covering collateral on a loan after it had been repaid.

It was against this backdrop that Congress acted in 1970. Both the Senate and House of Representatives passed legislation which was intended in part to give the Board greater discretion in administering the Act.[11]

[10] *See, e.g.*, General Contract Corp., 1959 Fed.Res.Bull. 260, Transamerica Corp., 1957 Fed.Res.Bull. 1014 (involving insurance underwriting rather than agency).

[11] Sen.Rep. No. 91-1084, 91st Cong., 2d Sess. 12 (1970), 1970 U.S. Code Cong. & Adm.News at p. 5530 (hereinafter referred to as "Senate Report"), provides:

> First, the language of the act will be amended to allow the Federal Reserve Board greater flexibility in determining what nonbanking activities and acquisitions are to be permitted bank holding companies.

The House Report, H.R.Rep. No. 91-387, 91st Cong., 2d Sess. 14 (1970) (hereinafter referred to as "House Report"), similarly states:

> The committee amendment gives the Federal Reserve Board added flexibility in administering the Act in terms Chairman Martin himself has suggested.

In particular, both houses approved a change of the "closely related" language of the 1956 Act to a requirement that nonbanking activities need be only "functionally related" to banking.[12] The two bills did not completely agree, however; the House of Representatives included a provision specifically prohibiting holding companies from engaging in six nonbanking activities, including insurance agency activities other than those relating to credit life, and credit health and accident insurance.

The conflict between the "functionally related" language, which clearly was intended to broaden to some degree the Board's discretion in approving nonbanking activities, and the specific prohibitions in the House bill made for a difficult Conference Committee session. Ultimately, the list of prohibited activities was deleted from the Act, apparently in return for a retention of the pre-1970 "closely related" language. Four of the seven House conferees[13] emerged to argue that the resulting legislation should "be construed to mean that the Congress was not convinced that such expansion and liberalization was justified." Conference Report, 1970 U.S.Code Cong. & Adm.News at p. 5572. *See also* 116 Cong.Rec. 41952, 41961 (1970) (remarks of Rep. Patman). The Senate conferees and the minority House conferees, however, argued that even the compromise bill which sur-

[12] This language was inserted at the request of the then-Chairman of the Federal Reserve Board, William McChesney Martin. *See* Conference Report, 1970 U.S.Code Cong. & Adm.News p. 5566; Senate Report, 1970 U.S.Code Cong. & Adm.News p. 5531.

[13] Those members of the Conference Committee signing the Conference Report were Rep. Wright Patman (D-Tex.), Chairman of the House Banking and Currency Committee, Rep. William A. Barrett (D-Pa.), Rep. Leonor K. Sullivan (D-Mo.), and Rep. Henry Reuss (D-Wis.). The Congressional practice in 1970 was that only House members would write a "statement of managers" accompanying Conference Reports. *See* 116 Cong.Rec. 42422 (1970).

vived the Conference represented a liberalization of the law.[14]

Certainly some other changes in the Act represent a modest broadening of the Board's discretion. The deletion of the requirement that the nonbanking activity be of a "financial, fiduciary, or insurance nature" and that it relate to the "business of banking" are examples.[15] And it can be argued that the belief of the majority of the entire Conference Committee should be given precedence over that of the slim majority of the House conferees. Nevertheless, on balance we cannot concur in the District of Columbia Court of Appeal's conclusion that "it is plain that Congress intended to expand [the Board's] latitude in substantial degree". 516 F.2d at 1236. Any liberalization of the standards effected by these minor wording changes was largely if not wholly offset by the Conference Committee's rejection of the "functionally related standard" and the addition of the public benefits test. The purpose and effect of the 1972 Amendments in this particular was quite ambiguous, and we find that no significant change in the general range of the Board's discretion was effected by them.

Despite petitioners' earnest efforts to persuade us to this conclusion, however, we find that it avails them little. One reason for this is that the pre-1970 law simply

[14] 116 Cong.Rec. 41952-53 (remarks of Rep. Widnall); *id.* 42422, 42424 (remarks of Sen. Sparkman); *id.* 42431 (remarks of Sen. Bennett).

[15] The latter change in particular was sought by the Board to make it clear that nonbanking activities need not relate to the particular banking business of the applicant but to banking in general, thus permitting activities in areas geographically removed from the applicant's bank operations. *See* Conference Report, 1970 U.S.Code Cong. & Adm.News pp. 5566-67. There is persuasive evidence that the insertion of the "functionally related" language was intended only to accomplish this, and not to effect a general broadening of permissible activities. *See* 116 Cong.Rec. 42434 (1970) (letter from Arthur F. Burns, Chairman of the Federal Reserve Board).

was not very restrictive in the insurance area. Petitioners correctly note that approval of many pre-1970 insurance applications was grounded in part on long established bank practices in the local area involved and the existence of bank competitors already carrying on insurance activities.[16] But, even so, the fact remains that the Board between 1956 and 1970 rejected the first two applications to engage in insurance activities and thereafter granted all twenty-five applications which came before it, many without reference to local practices; this hardly bespeaks a highly restrictive policy.

Petitioners have been able to cite nothing in the legislative history to indicate disapproval of the Board's pre-1970 decisions. To the contrary, the Senate Report stated that

> the deletion of [the restriction to "financial, fiduciary, or insurance" activities] shall not be construed as indicating the committee's intent that these activities be no longer permitted. To the contrary, these activities are "functionally related to banking" and are included under the new provision adopted by the committee *to the full extent they were permitted under the existing act*, and to such additional extent as the Board may find it desirable under the new criteria established.

Senate Report, 1970 U.S.Code Cong. & Adm.News at p. 5533 (emphasis supplied). Of course, the "functionally related" language disappeared in conference, but even the House members who held the more restrictive view of the resulting legislation quoted the Senate Report's language, emphasizing that "these . . . are included . . . to the full extent they were permitted under the existing act." Conference Report, 1970 U.S.Code Cong. & Adm. News at p. 5565. *See also* 116 Cong.Rec. 41963 (remarks of Rep. Reuss).

[16] *E.g.*, Bank Shares, Inc., 45 Fed.Res.Bull. 954 (1959); First Bank Stock Corp., 45 Fed.Res.Bull. 917 (1959).

We have, then, a series of interpretations of the "closely related" standard with respect to insurance activities, over a period of fourteen years, by the agency charged with setting the machinery of the Bank Holding Company Act in motion. *See Chemehuevi Tribe of Indians* v. *FPC*, 420 U.S. 395, 409-10, 95 S.Ct. 1066, 1075, 43 L.Ed. 2d 279, 290 (1975); *Trafficante* v. *Metropolitan Life Ins. Co.*, 409 U.S. 205, 210, 93 S.Ct. 364, 367, 34 L.Ed.2d 415, 420 (1972); *FDIC* v. *Summer Fin. Corp.*, 451 F.2d 898 (5 Cir. 1971). The "great respect" that is due such interpretations "is enhanced by the fact that Congress gave no indication of its dissatisfaction of the agency's interpretation of the scope of its . . . jurisdiction when it amended the Act." *Chemehuevi Tribe of Indians, supra. See Saxbe* v. *Bustos*, 419 U.S. 65, 95 S.Ct. 272, 42 L.Ed. 2d 231 (1974); *Reeb* v. *Economic Opp'y Atlanta, Inc.*, 516 F.2d 924 (5 Cir. 1975). We must be most reluctant then, to reach results which would repudiate pre-1970 Board decisions, particularly in view of the fact that the Board's expertise in this area must be presumed to exceed ours. *See Brenan* v. *General Tel. Co.*, 488 F.2d 157, 160 (5 Cir. 1973).

A second reason why petitioners have a difficult burden derives from our limited role in reviewing these regulations. Because this regulation does not involve findings "required by statute to be made on the record after opportunity for an agency hearing," *see* 5 U.S.C. §§ 553, 556-57 (1970); *Couriers*, 516 F.2d at 1235 n. 6, the "substantial evidence" standard of review is not the proper one. *See United States* v. *Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 749, 92 S.Ct. 1941, 1946-47, 32 L.Ed.2d 453, 460 (1972); *Couriers*, 516 F.2d at 1235 n. 7. Instead, we need determine only whether the Board's findings of fact are "arbitrary, capricious, an abuse of dis-

cretion, or otherwise not in accordance of law", 5 U.S.C. § 706 (1970), and determine questions of law for ourselves. *Couriers*, 516 F.2d at 1235-36.

With these observations we turn to the portion of § 225.4(a)(9) under primary attack. It provides that a holding company subsidiary may act as an insurance agent or broker with respect to:

> (ii) Any insurance that (*a*) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (*b*) is directly related to the provision of other financial services by a bank or such a bank-related firm. . . .

The immediately apparent fact is that these sections represent only slightly more narrow definitions than the "closely related" language itself. They state in essence that one type of "close" relation to banking exists when there is a "direct" relationship of the activity to an extension of credit or other financial service. Since the essential function of banking is the provision of credit or other financial services, the primary result of the regulation itself is merely to shift the inquiry from the word "close" to "direct". Such a minute change cannot be deemed outside the Board's discretion; if there is invalidity in the Board's action pursuant to this regulation, it must be in the application of the regulation to the particular activities authorized under it.

Other parts of § 225.4(a)(9) represent more substantial departures from the wording of the Act. The first example is subsection (i), which permits the sale of "any insurance for the holding company or its subsidiaries".[17] Acting pursuant to this authorization, the

[17] Petitioners have not specifically attacked this portion of § 225.4(a)(9), but in view of their general contention that insurance agency activities other than the sale of credit life, and credit, health and accident insurance are not "closely related" to banking. Brief for Petitioners at 45, 49, *Alabama Ass'n of Ins. Agents, Inc.* v. *Board of Governors*; Brief for Petitioners at 46, 51, *Georgia Ass'n of Ind. Ins. Agents* v. *Board of Governors*, it is our duty to determine its validity.

Board approved applications by both Southern and First National and authorized the sale of any insurance within the terms of subsection (i).

It is apparent that at least some of the insurance sales thereby permitted will relate only tangentially to the basic functions of banks: the protection of savings and the provision of financial services. For example, the regulation would authorize the sale of group health insurance for janitorial and maintenance employees, and property insurance on the physical assets of banking subsidiaries, such as bank fixtures or real property owned by the bank. Moreover, sales of insurance to the holding company or to nonbanking subsidiaries would be permitted. In the case of First National, for instance, the insurance subsidiary could sell insurance to Gulf Finance Corporation of Mississippi or Woods-Tucker Leasing Company, which has offices in Mississippi and Louisiana. However, convenient to the holding company it is to eliminate the need to pay the commissions of an unrelated insurance broker for such insurance, the relationship of the brokering of such insurance to *banking* is difficult to discern.

We do not seek to be restrictive in determining what types of relationships to banking are cognizable under the Act. As the *Couriers* court stated, activities meeting the following criteria seem permissible:

1. Banks generally have in fact provided the proposed services.
2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.

3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form.

516 F.2d at 1237. Clearly, however, brokering insurance for even those subsidiaries of a holding company which are banks does not come within these strictures. We have been apprised of no general practice on the part of banks (and certainly the Board has not articulated one) to broker the types of insurance that they need for their own account and we know of no evidence that they have provided "functionally" or "integrally" related insurance services. Certainly any past practice in which banks have engaged in this area does not cover "any" type of insurance which the banks or their subsidiaries might require.

We are willing, however, to consider broader types of relationships. For example, it cannot be doubted that many types of insurance for banking subsidiaries are helpful, and perhaps essential, to the success of the enterprise, and thus to the provision of financial services. Such insurance may protect the physical facilities which are necessary to banking, insure the fidelity of the employees who are intimately involved in banking operations, or insure the availability of necessary health care for the employees who directly or indirectly provide financial services. The relationship of such insurance to "banking" is in some cases quite indirect; in many cases the bank's need for it is no different than the need of any business enterprise. But in view of the limited role of this court in reviewing these regulations, we are unwilling to say that the Board was wrong in finding it sufficient.

As noted above, however, even this rationale cannot justify the Board's authorization of the holding companies to broker insurance for themselves or their non-

banking subsidiaries. Such insurance simply does not contribute to the operations of those subsidiaries actually engaged in the banking business. Perhaps it could be argued that uninsured losses of those businesses or of the holding company may affect the availability of resources to the banking subsidiary or other policies of the directors or shareholders of the holding company, who directly or indirectly control the banking subsidiaries. But the Board has not, to our knowledge, articulated this rationale and, in any event, it seems to us so attenuated as to stray even from the broad area of discretion to which the Board is entitled. We therefore find that the portion of § 225.4(a)(9)(i) which authorizes the sale of insurance for bank holding companies and nonbank subsidiaries of holding companies must be invalidated, and the portions of the orders under review which authorize the sale of such insurance must also fall.

A second specific provision in the regulation is (ii)(*c*), which authorizes holding company subsidaries to act as agents with respect to insurance that

> is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(*c*) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii). . . .

The Board argues that this provision "permits the holding company agency to round-out its insurance offerings" by, for example, permitting renewal of policies covering an automobile after a loan from a holding company bank on the automobile has been repaid. The Board stresses also that, in its interpretive regulation, 12 C.F.R. § 225.128(e), it limited premiums from sales of "convenience insurance" to less than five per cent of the aggregate premium income of the holding company agency, and stated specifically that this provision was

not designed to permit entry into a general insurance agency business. It further argues that, as the business of a holding company agency increases over time, a larger portion of its convenience insurance sales will be renewals of insurance on property on which indebtedness has been fully repaid, until that is the only type of convenience insurance sold.

The Board may well be correct in its forecasts. And it may be correct in assuming that such renewal insurance would be "closely related" to banking within the meaning of the Act. But the fact is that the regulation is not so restricted. It permits holding company affiliates to sell *any type of insurance under any conditions* as a "matter of convenience", imposing no condition that the insurance relate in any way to banking.

The court in the *Couriers* case was faced with a similar provision, which authorized holding company affiliates to furnish "courier services for non-financially-related material upon the specific, unsolicited request of a third party when courier services are not otherwise reasonably available." 12 C.F.R. § 225.129 (1974). Although the court was willing to agree that an affiliate could engage in such incidental activities as were reasonably necessary to carrying out those that were closely related to banking, it stated that:

> The justification for the "incidental" courier services at issue here is, however, quite different. It is not, as far as we can tell, that the carriage of non-financially related material is in any way necessary to the successful operation of the courier service affiliates. Rather, it is that the provision of such service would "serve the convenience of the public".

516 F.2d at 1240.

The court then noted that the provision of such services might indeed be beneficial to the public, in view of the

fact that bank affiliates would not likely become deeply involved in providing such unsolicited services, and that no bank competitor would be injured since the services were required to be "otherwise unavailable". The court then made a statement with which we fully agree:

> But Congress did not instruct the Board to allow or disallow bank involvement in non-financial activities as may be required by the policies which counsel a separation of commerce and banking. Having heeded that counsel itself, it decreed the separation, and instructed the Board to enforce it.

516 F.2d at 1241.

Here, too, we believe the Board has misconstrued its role. The Board's function is not to promote generally the public interest consistent with the policies of the Bank Holding Company Act, but to determine what activities are "closely related" to banking. While we might agree that the sale of certain types of convenience insurance would help a holding company agency "round out" its offerings to the benefit of its clients, the agency, and the general public, the fact remains that the handling of convenience insurance simply is not, as broadly defined in the regulation, closely related or necessarily related at all to banking.

The Board, however, argues that the brokering of convenience insurance is "a *necessary* activity to the operation of an affiliated insurance agency". To the extent that this is an assertion that it is an incidental activity reasonably necessary to the carrying on of clearly permissible ones, we find that it is one that, if supported, would be legally sufficient. *See* 12 C.F.R. § 225.4(a) (1976); *cf.* 12 U.S.C. § 24 (1970) (authorizing national banks "to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking"). But we see no possible argument that the regulation, as

written, meets this standard in view of its failure to restrict the types of insurance authorized. Moreover, as the Board itself argues, the provision would enable an agency to meet "peculiar additional insurance needs of a few of its customers"; it is difficult to see how such a power could be deemed "necessary" to the agency's operation. Although the Board may redraft § 225.4(a)(9)(ii)(c) in a way that meets the "closely related" standard, we must hold that provision as it stands invalid and reverse those portions of the orders in question which authorize the sale of convenience insurance.

A final provision which must be examined is § 225.4(a)(9)(iii) of Regulation Y, which permits a holding company agency to sell:

> Any insurance sold in a community that (*a*) has a population not exceeding 5,000, or (*b*) the holding company demonstrates has inadequate insurance agency facilities.

This provision, too, seems to authorize the handling of insurance for the benefit of the public, despite the absence of any discernible connection to "banking". It is interesting to note, however, that Congress has since 1916 permitted national banks to engage in just such activity. 12 U.S.C. § 92 (1970). The question then arises whether the Congressional determination that such activity is permissible for national banks alone is sufficient to render it "closely related to banking" for purposes of the Bank Holding Company Act.

The answer to this question can be found in the legislative history of 12 U.S.C. § 92, which this court examined in *Saxon* v. *Georgia Ass'n of Ind. Ins. Agents, Inc.*, 399 F.2d 1010 (5 Cir. 1968). In that case, we placed emphasis on a letter from the Comptroller of the Currency to the Senate Banking and Currency Committee in 1916

which revealed that his primary purpose in proposing the legislation was to give small town banks, which had difficulty in deriving a sufficient profit from banking, an additional source of revenue. The Comptroller stated that:

> This additional income will strengthen them and increase their ability to make a fair return to their shareholders, while the new business is not likely to assume such proportions as to distract the officers of the bank from the principal business of banking.

399 F.2d at 1015. It clearly appears, then, that 12 U.S.C. § 92 was enacted not out of a belief that there was any significant connection between banking and the sale of insurance in small communities, but merely because it was believed that banks needed an additional source of income to improve their stability and profitability. Congress thus did not indicate that the sale of insurance in small towns was part of "banking", but rather that it was an unrelated business which would provide a source of income that would then be available for use in the separate banking activities of small town national banks.

No one doubts that subsidiaries of holding companies which are national banks located in small towns have the authority to broker insurance. But to hold that other holding company subsidiaries which are not banks have such authority as a result of 12 U.S.C. § 92 would not only violate the Bank Holding Company Act, but would warp the Congressional intention underlying the 1916 enactment as well. Whatever benefits in terms of convenience to the public or profit to holding companies may accrue as the result of granting affiliates power to sell insurance in small towns, it can hardly be argued that such authority is necessary to protect the stability of the banking (or other) subsidiaries of holding companies or to permit a fair rate of return to their shareholders. The purpose of Congress in enacting 12 U.S.C. § 92 simply does not apply

to the bank holding companies, and that provision cannot serve as the sole authorization for a determination that insurance sales in small towns are "closely related to banking".

This is made even more apparent by the fact that the Board regulation is not even restricted to holding company subsidiaries which are *located* in small communities. Unlike the national banks which were the object of the 1916 provision, the holding company affiliates which would sell this insurance would be located in downtown Birmingham or Atlanta and have full access to the commercial opportunities of major metropolitan areas and beyond. For all of these reasons, we must hold that § 225.4(a)(9)(iii) of Regulation Y is invalid and that the portions of the orders before us which are based upon it must also fall.

III. Application of the Regulation

We turn now to one of the most hotly contested aspects of this case: the Board's authorization of holding company sales of property damage and liability insurance. The "property damage" insurance referred to would protect collateral for loans by holding company banks from damage caused by fires, storms, accidents, and other hazards. The liability insurance at issue would protect borrowers from liability resulting from injury or damage to the person or property of others in connection with property financed by holding company banks. Thus, for example, a bank financing and taking a security interest in an automobile might also sell the owner-borrower collision insurance and insurance against any liability arising from an accident in the automobile. The Board found that both property damage and liability insurance were "directly related to an extension of credit" and therefore within § 225.4(a)(9)(ii)(*a*) of Regulation Y.

Petitioners argue primarily that the sale of physical damage insurance is unauthorized because it is neither

"functionally equivalent to an extension of credit" nor "operationally integrated into the lending transaction". As noted earlier, we are not convinced that Congress intended to so limit the universe of relevant connections between banking and proposed nonbanking activities. To the contrary, we believe that the Board should be upheld when it articulates any type connection between banking and the nonbanking activity in question which makes it rational to consider the proposed activity an "incident" to banking.

In approving the sale of property damage insurance, the Board stressed the fact that such insurance is "essential from the lender's standpoint to assure that the value of the collateral will not be impaired by physical damage." II App. 187; IV App. 732. The Board also noted that such insurance performs "an integral function for the borrower as well, since the presence or lack of insurance protecting loan collateral is an essential element of the credit evaluation." II App. 187. Its decision, then, was based neither on any historical practice by banks, nor upon any process characteristic of lending transactions which would necessitate specialized forms of the activity at issue. The Board seems to have relied simply on the fact that, in lending transactions, banks have a legitimate *need* for physical damage insurance to protect the value of the collateral and that borrowers have *need* for the insurance to obtain credit. We hold that this is enough, particularly in view of the pre-1970 authorization of similar insurance sales. *See* Citizens and Southern Holding Co., 1969 Fed.Res.Bull. 673; Otto Bremer Co., 1969 Fed. Res.Bull. 388; Otto Bremer Co., 1967 Fed.Res.Bull. 1555. Where a product or service is regularly desired by both parties and supports the transaction in some significant way, we cannot say that the Board acts irrationally or arbitrarily in deeming the furnishing of the product or service "closely related to banking" or "directly related to an extension of credit".

The case for liability insurance proceeds upon the same general lines but is significantly weaker. Liability insurance protects the borrower's ability to repay a loan, which could otherwise be destroyed by an accident or other catastrophe. It therefore fulfills a need of both the borrower and lender, particularly where the borrower is an individual or a small business with limited assets. Petitioners note, however, that liability insurance, unlike physical damage insurance, is not required of borrowers as a general banking practice. And the authorization at issue is in no way limited to cases where the borrower's ability to repay could be significantly affected by an uninsured liability.

This is not surprising in view of the fact that the Board's orders in these cases relied on an entirely different rationale. The Board stressed the insurance industry practice of selling liability insurance in conjunction with property damage insurance protecting an automobile or other property. It concluded that

> a "packaged" insurance policy, combining liability insurance with insurance relating to physical damage on property purchased from loan proceeds, fulfills a legitimate need of the lender and borrower alike at the time a loan is made. Moreover, in the case of homeowner's insurance, it appears that it would not be economical for a borrower to procure separately the various coverages customarily packaged in such a policy.

II App. 188; *see* IV App. 733. The Board's rationale therefore comes down to this: (1) borrowers, for convenience and, in some cases, cost reasons, want liability insurance packaged with property damage insurance, which itself is incident to banking; (2) the need for liability insurance arises out of the lending transaction; (3) liability insurance to some extent protects the borrower's ability to repay the loan.

We find that these form a sufficient basis for the brokering of liability insurance by bank holding companies. The evidence amply supports the conclusion that, from the consumer's point of view, packaged property damage and liability policies are more desirable than the same policy separately sold. *See* II App. 273, 278, 309-10, 411-12; V App. 1228. To permit banks to sell only property damage insurance, then, could have the effect of substantially limiting the gains in convenience and in increased competition which Congress sought to promote. The sale of packaged liability insurance therefore may be seen as an activity "incidental" to the sale of property damage insurance and necessary for the effectuation of the Congressional purpose with respect to the latter activity. *See* 12 C.F.R. § 225.4(a) (1976); *Couriers*, 516 F.2d at 1240.

It cannot be said, moreover, that the relationship of banking to liability insurance itself is chimerical. Although banks do not customarily require it, liability insurance does in a significant way "support the lending transaction". Indeed, assurance of the borrower's ability to repay the loan may be more important than protection of the collateral; repayment rather than repossession is the bank's primary objective. And, too, the need for the insurance does arise directly from the purchase of property, which is the very purpose of the loan. In attempting to answer the question whether these relationships are sufficient to establish the connection that Congress required, we have been impressed by the pre-Amendment decisions of the Board. In two cases decided in the year prior to the passage in 1970 of the provision we are construing, the Board granted applications authorizing the sale of liability insurance by a bank holding company agency, without any requirement that it be packaged with

other insurance. United Virginia Bankshares, Inc., 1970 Fed.Res.Bull. 599, 600; First Security Corp., 1969 Fed. Res.Bull. 667, 668. Yet Congress made no substantial change in the language of the relevant provision and the legislative history is void of any suggestion that the pre-Amendment decisions were disapproved. In view of the familiar presumption that the legislature is aware of existing constructions of statutes which it reenacts,[18] this court has every reason to believe that the more limited authorization of liability insurance in these cases was within the intent of Congress.

IV. The Calculus of Public Benefits

The 1970 Holding Company Act Amendments transformed the general question of whether the proposed activity would be a "proper incident" to banking, in part at least,[19] into the more particularized inquiry of whether

[18] *T.I.M.E., Inc.* v. *United States*, 359 U.S. 464, 79 S.Ct. 904, 3 L.Ed.2d 952 (1959); *Shapiro* v. *United States*, 335 U.S. 1, 68 S.Ct. 1375, 92 L.Ed. 1787 (1948); *United States* v. *Douglas Aircraft Co.*, 510 F.2d 1387 (Ct.Cust. & Pat. App. 1975); *Kansas City* v. *Federal Pac. Elec. Co.*, 310 F.2d 271 (8 Cir. 1962), *cert. denied*, 371 U.S. 912, 83 S.Ct. 256, 9 L.Ed.2d 171 (1963).

[19] As noted earlier, the Board in its order in the Georgia case evidenced a belief that its determination in § 225.4(a)(9) that certain insurance activities are closely related to banking also served as a determination that those activities "in general" satisfy the public benefits test. Without ruling on the correctness or incorrectness of this statement, we note that Chairman Burns of the Federal Reserve Board indicated in a letter to the Conference Committee his belief that the

> language of the statute should make clear that there are two tests to be satisfied in deciding whether nonbank subsidiaries of bank holding companies should be allowed to engage in a particular activity: (1) whether the activity is closely related to banking, and (2) whether it is a proper incident to banking, and that in applying the second test, the Board is to weigh the possible benefits to the public against the risks of adverse consequences. We believe that the language proposed by the House conferees might be misconstrued to apply three tests: (1) whether the activity is closely related, (2) whether it is a proper incident to banking, and (3) whether the benefits outweigh the risks.

116 Cong. Rec. 42434 (1970). The Chairman, whose suggestions on this matter were heeded by the Committee, thus seems to have regarded the "closely related" and "proper incident" determinations as wholly separate.

the activity "can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects". 12 U.S.C. § 1843(c)(8) (1970). Nonexhaustive examples of such benefits (greater convenience, increased competition, and gains in efficiency) and adverse effects (undue concentration of resources, decreased or unfair competition, conflicts of interest, and unsound banking practices) were listed by Congress in the statute. In this case, the Federal Reserve Board made specific findings as to each of these factors and, overruling the Administrative Law Judge, held that each of the possible benefits were likely to be realized if the applications were granted and that none of the possible adverse effects were likely to occur. The Board thus concluded that overall public benefits very clearly outweighed possible adverse effects.

Congress in the 1956 Act clearly circumscribed our role in reviewing the Board's findings: "[t]he findings of the Board as to the facts, if supported by substantial evidence, shall be conclusive". 12 U.S.C. §1848. If such support exists in the record, it is our duty to affirm even though we might come to a diametrically opposite conclusion on our own. *North Hills Bank* v. *Board of Governors of Federal Reserve System*, 506 F.2d 623 (8 Cir. 1974); *Comm'l Nat'l Bank of Little Rock* v. *Board of Governors of Federal Reserve System*, 451 F.2d 86 (8 Cir. 1971); *First Wisconsin Bankshares Corp.* v. *Board of Governors of Federal Reserve System*, 325 F.2d 946 (7 Cir. 1963). This is particularly true with respect to matters relating to banking industry structure and operations, areas in which the Board may be presumed to have expertise. *Commercial Nat'l Bank supra; North-*

west Bancorporation v. *Board of Governors of Federal Reserve System*, 303 F.2d 832 (8 Cir. 1962).

The reasons for deference to the Board's reasoned judgment in the general run of cases are magnified in the context of the "public benefits" determination of § 4(c)(8). Congress required only that public benefits "reasonably" be expected to outweigh adverse effects. In so doing, it indicated recognition of the fact that the judgments required of the Board are necessarily imprecise and to some degree speculative. Not only do they relate to complex future events—often unprecedented ones—but they concern aggregate rather than discrete effects. Thus, the Board must determine not whether there will be one or more aspects of insurance agency activity by holding company affiliates that will tend to produce efficiency gains, but whether, *overall*, such aspects will outweigh possible sources of efficiency loss sufficiently to produce net gains. The latter determination is much more difficult than the former, and is one which is much less susceptible to detailed evidentiary support. Unless we are to impose insurmountable barriers upon those who seek to take advantage of the § 4(c)(8) authorization, which was reaffirmed by Congress in 1970, our review must be sensitive to these circumstances. *See, e.g., Bowman Transp., Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 292-94, 95 S.Ct. 438, 446, 42 L.Ed.2d 447, 460 (1974).

We note, however, that the Board's rejection of the Administrative Law Judge's conclusions cuts the other way. While the Board is in no way bound by those conclusions, *e.g., Bowman Transp., Inc.* v. *Arkansas-Best Freight System, Inc., supra*, 419 U.S. at 297-98, 95 S.Ct. at 447-48, 42 L.Ed.2d at 462-63, "evidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn conclusions different from the Board's than when he has reached the same conclusion". *Universal Camera* v. *NLRB*, 340 U.S. 474, 496, 71 S.Ct. 456, 469, 95 L.Ed. 456, 472 (1947). Although we are inclined to uphold the Board where it clearly explains its reasons for differing with the Administrative Law Judge (particularly on issues upon which it may be presumed to have particular expertise), its findings will be vulnerable where it merely announces an opposite conclusion from the Administrative Law Judge without explanation. *See Greater Boston Television Corp.* v. *FCC*, 143 U.S.App.D.C. 383, 444 F.2d 841, 853 (1970), *cert. denied*, 403 U.S. 923, 91 S.Ct. 2229, 29 L.Ed.2d 701 (1971).

A. *Greater Convenience*

The Administrative Law Judge found no likelihood of increased convenience in the Southern case and a likelihood of only "minimum" increased convenience in First National's. The Board disagreed in both instances, relying primarily on its belief that the "one-stop shopping" that would be made possible would save consumers an extra trip to an insurance agent and would avoid the necessity of obtaining the same information from the consumer twice—once for the loan and once for insurance. It noted that "borrowers have often requested insurance from Applicant's banks in the past" in support of its contention that there is a demand for the postulated added convenience. The Board now argues also that the consumer would thereby be assured that he has insurance coverage satisfactory to the lender and that insurance and loan payments could be combined in a single bill, resulting in further consumer convenience.

As the NAIA parties argue, the Board's conclusions on this issue are cast in doubt by the fact that the licensed insurance agents in both cases will be located at central offices in Birmingham or Atlanta. The result is that, although loan officers around the area or state can telephone

such agents to make insurance arrangements at the time loans are made, any dealings by borrower-insureds living outside those metropolitan areas with the agents thereafter will be on an impersonal and long-distance basis. Relationships with local independent agents, on the other hand, can be conducted on a more personal basis and face-to-face discussion of insurance matters will be much easier to arrange. The Board showed no recognition whatever of the resulting decrease in convenience.

Moreover, the Board made no attempt to explain why *non-affiliated* insurance agents could not effect the same convenience through a one-stop shopping system. Loan officers could (and if there is a genuine bank need to insure that acceptable coverage be secured, they *will*) suggest to the prospective loan customer a reputable local agent; if the customer is willing, that agent could be telephoned and could perform the same functions as the proposed holding company affiliate agent.

In its brief, First National suggests that a practice of recommending independent insurance agents to borrowers would not be "good business policy or good ethics".[20] This may or may not be true, but what is clear is that the Board made no such argument and that we have been directed to no evidentiary support in the record for that conclusion. The same situation exists with respect to the claim of added billing convenience; it is one advanced *post hoc* by the Board with no evidentiary support which has been pointed out to us. *See Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168-69, 83 S.Ct. 239, 246, 9 L.Ed.2d 207, 216 (1962); *City of Lafayette* v. *SEC*, 147 U.S.App.D.C. 98, 454 F.2d 941 (1971), *aff'd sub nom. Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 93 S.Ct. 1870, 36 L.Ed.2d 635 (1973). Because of these

[20] Southern, on the other hand, has referred customers to a number of insurance agencies upon request. II App. 229.

deficiencies, and particularly because of the Board's failure to delineate clearly the sources of its disagreement with the conclusions of the Administrative Law Judge, we must find that its conclusion on this point is not supported by substantial evidence.

B. *Greater Efficiency*

The dispute on this point centers around the insurance industry practice of "direct billing", by which insurance underwriters, rather than agents, issue the policy to the customer and bill and collect the premiums. There was evidence that this practice results in lower commissions to the agent and lower premiums for the consumer. Because both First National and Southern indicated that they probably would not use "direct billing", the Administrative Law Judge concluded that any possible gains in efficiency from elimination of advertising and soliciting expense and from combination of billing would be negated, and that therefore there was no reasonable likelihood of efficiency gains.

The Board, however, concluded that reduction of advertising and solicitation expenses, the elimination of present bank difficulties in obtaining verification of automobile insurance renewals, the possibility of establishment of a "common pattern of operations" between loan officers and the single insurance agency, and certain "technical efficiencies in the data processing area" would constitute efficiency gains resulting in a public benefit.[21]

[21] II App. 193-94; IV App. 737. We note initially that there is some dispute over the precise character of the efficiency gains referred to in the statute. The NAIA parties apparently contend that gains in efficiency are not relevant for the purpose of the statute unless the applicant can demonstrate that they will be passed along to the consumer. We find no basis in the statute for this argument; the statute requires consideration of "gains in efficiency" and apparently *assumes* that such gains will constitute "public benefits".

To be sure, improved service or lower prices to the consumer are one type of public benefit, but it is also true that a public benefit

Significantly, in neither the First National nor the Southern order did the Board even mention the direct billing concept or the Administrative Law Judge's reliance thereon.

After examination of the record, we find substantial evidence to support the Board's conclusions that some of the types of efficiency gains it relied upon in the orders were reasonably likely to result. Although the briefs of the NAIA parties make abundantly clear that the evidentiary showings in favor of these conclusions were much weaker than they could have been, it is not our function, nor the Board's, to require the strongest showing possible. Even without the professional studies, the detailed projections, and the unequivocal expert testimony that the NAIA parties deem essential, there is significant evidentiary support for the conclusions that there will be an avoidance of advertising and solicitation expenses, some elimination of duplicated information gathering and information sharing, and some efficiencies in data processing.

But the Board again has failed utterly in its responsibility to consider possible sources of efficiency loss and to arrive at a reasoned evaluation of *net* efficiency gains. It may well be that the Board could properly have concluded that a net gain would result or that, as First National suggests in its brief, the holding company affiliates would in the future adopt direct billing. But the

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in a broad sense is conferred whenever a service is performed in a new way which requires less of society's limited human and economic resources. The result may be lower prices to the consumer of the service, or it may be greater dividends to the body of stockholders of the service provider, better salaries or benefits to the provider's employees, or the availability of greater capital for expansion of the business. In the latter instances as well as the former we believe that efficiencies reasonably can be said to result in a public benefit: the freeing of scarce resources for beneficial economic use.

fact remains that, despite the Administrative Law Judge's explicit reliance upon the negative efficiency effects of non-use of direct billing, the Board failed to so much as mention the issue. Because of this failure, we cannot uphold the Board's finding on this issue.

C. *Increased Competition*

Because insurance premium rates are set by insurance underwriters and subject to state regulation, competition on the basis of price among insurance agents is limited. Because of this, the Administrative Law Judge found that there was no "hard evidence" that there would be increased competition in the Georgia case. The Board, however, agreed with the Law Judge's conclusion in the Alabama case that, although price competition would be limited, the applications would result in increased competition on the basis of service. In particular, the Board concluded that the greater convenience to consumers of "one-stop shopping" and the availability of bank financial expertise to insurance customers would force independent agents to increase their service efforts to compete with the holding company affiliates.

Here we find sufficient evidence to support the Board's conclusions and no unexplained conflict with the Law Judge's findings. To the evidence that there would be some pressure for lower prices, we must add the customer-attracting advantages of one-stop shopping and the financial expertise of loan officers, for which there is support in the record.[22] While the evidence on this is-

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[22] *See, e.g.*, II App. 249-51, 283-84, 307-08, 311, 313; III App. 562, 592-95; IV App. 768-70, 811, 836-37, 838-39, 842-44, 863-64, 869, 880-81; V App. 1225, 1227-32, 1268, 1274-77. Even though the finding of greater convenience could not be upheld, we must note the evidence in support of that conclusion as one factor tending toward a conclusion that service competition will result. This is so because the likelihood of increased service competition depends

sue certainly can be described as vague, we find that in light of the realities of such applications, it is enough.

We find that this conclusion is bolstered by two factors not specifically relied upon by the Board. The first is that the entry by both Southern and First National into most of these lines of business will be *de novo*, rather than by purchase or merger with an existing competitor. *See* III App. 716; V App. 1230. It is quite clear that Congress "believe[d] that an activity commenced de novo will tend to have procompetitive effects, and consequently should be viewed more favorably than the commencement of an activity through the acquisition of an existing concern". Senate Report, 1970 U.S.Code Cong. & Adm.News at p. 5534. *See* Conference Report, 1970 U.S.Code Cong. & Adm.News at p. 5568; 12 U.S.C. § 1843(c)(8). Additionally, we take congnizance of the unusual competitive situation which presently obtains in the Georgia case. Citizens and Southern Holding Company, whose bank subsidiary has the largest share in the Atlanta banking market, already has authority to sell many of the types of insurance at issue here. *See* V App. 1349-50. It may reasonably be expected, then, that granting First National's application will result in the introduction of further competition in the sub-area of bank-related insurance sales, and indeed will better enable First National to compete with Citizens and Southern in the provision of banking services as well.

D. *Decreased or Unfair Competition*

The primary claim of the NAIA parties with respect to this issue relates to the possibility that insurance sales will be "tied" to bank loans, thus reducing competition for reasons unrelated to efficiency. The claim is that loan

upon consumer *perceptions* of convenience and the response of independent agents to this perception, rather than the actual results concerning increased convenience.

officers may require prospective borrowers to insure through holding company affiliates as a condition for obtaining a loan (coercive tying) or that prospective borrowers may act on a belief that insuring through the holding company will be helpful or necessary in obtaining a loan, without being required to do so (voluntary tying).[23] The Administrative Law Judge noted that coercive tying was prohibited by the Holding Company Act Amendments of 1970, 12 U.S.C. § 1971 *et seq.*,[24] but found that voluntary tying was "a distinct possibility", particularly in times of tight money. The Board, however, found that there were no instances of voluntary tying described in the record, that the percentage of loan customers to which Tharpe & Brooks and a North Carolina bank holding company had sold insurance were not great, and that there were numerous other lenders, both bank and nonbank, to whom customers could look. It ruled that there was no reasonable likelihood of significant voluntary tying in either the Alabama or Georgia case and that the Law Judge's requirement that specific statements regarding tying be incorporated in loan applications was not necessary.

The debate over voluntary tying[25] well illustrates the

[23] As the NAIA parties note, there is a spectrum of possible activities between overt coercive tying and purely voluntary tying. Bank loan officers may pointedly question about the prospective borrower's intended insurance agent at a critical point, strongly recommend the bank-affiliated agent prior to making the loan decision, or use other effective but indirect pressuring tactics.

[24] 12 C.F.R. § 225.4(c) extends the prohibition against coercive tying from banks to other bank holding company subsidiaries approved under § 4(c)(8) of the Bank Holding Company Act.

[25] We find that the Board's conclusion as to coercive tying is amply supported by the evidence. Not only is coercive tying specifically prohibited by law (and both applicants have pledged to observe the law), but the Board's Regulation Z, 12 C.F.R. § 226.4 (a)(5), (6), requires disclosure to lenders that the customer may

difficulty of the judgments entrusted to the Board under the Amendments. The Board was required to surmise the reasonable likelihood, in the future, of occurrences which are incapable of direct measurement even in the past. In its attempt to do so, the Board relied on two indirect indicia: past "penetration rates" and market structure. A penetration rate, which in this case is the percentage of borrowers from a particular lender who purchase insurance from the lender's affiliate, is an indication of the upper limit of possible voluntary tying. Since borrowers may purchase the insurance from lenders for other reasons, such as greater convenience, a strong personal relationship with the lender, or better price or service, the actual rate of voluntary tying may be much lower than the penetration rate.

A First National officer testified that its subsidiary, Tharpe & Brooks, had experienced a penetration rate of 13.5 per cent with respect to mortgage lending. IV App. 830-31. And a North Carolina bank holding company also reported a low penetration rate by its insurance subsidiary operating a general insurance business. I App. 120. We agree with the NAIA parties that it would have been helpful to have further evidence on penetration rates, with information on rates with respect to particular types of loans, and with detailed consideration of the relevance of the North Carolina and Tharpe & Brooks rates to the applications at hand. But we find that this evidence is credible, significant support for the Board's conclusion, particularly in view of the fact that the NAIA parties failed to present evidence or penetration rates contradicting the conclusions it suggested.

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choose the person through which any insurance is to be obtained. More importantly, the NAIA parties were able to produce no evidence of coercive tying on the part of either applicant.

Second, the Board considered the structure of the respective lending markets, recognizing that the possibility of voluntary tying is inversely related to the availability of other sources of credit. In so doing, the Board responded to the Congressional belief that "the dangers of 'voluntary' tie-ins and reciprocity are basically structural". Conference Report, 1970 U.S.Code Cong. & Adm.News at p. 5569. In the Alabama case, the evidence showed that there are six to twenty banking alternatives in each of the markets in which Southern subsidiaries operate, and that borrowers also have access to nonbank lenders such as finance companies, savings and loan associations, mortgage bankers, and credit unions. III App. 663-70. The Board in the Georgia case also relied upon the existence of other lenders as well as competition from over thirty banks in the Atlanta area. V App. 1233-34, 1327, 1330. We find these structural characteristics persuasive in support of the Board's conclusions as to voluntary tying. Despite the fact that there are bank subsidiaries in the Alabama case which have leading shares in individual market areas, and that there may be particular types of commercial loans for which there are few alternative lenders, there was a reasonable basis for the conclusion that the *total* amount of possible voluntary tying was not of the magnitude Congress was concerned about. This, we believe, is the relevant inquiry, for the size of bank holding companies in 1970, as today, is such that many will have individual markets in which, for certain types of loans, they will be the only practical source of credit. To conclude that the existence of any individual instances of market hegemony necessarily requires a conclusion that voluntary tying is likely would require a finding of this adverse effect in a great number of applications. We find no evidence that Congress intended so particularized and stringent an inquiry, and hold that an overall estimation of the magnitude of likely tying is

proper. The Board's conclusion on this issue is supported by substantial evidence.[26]

E. *Undue Concentration of Resources*

The NAIA parties challenge the Board's conclusion that the size of the projected insurance agencies, the degree of concentration in the relevant banking markets, and the existence of alternative sources of loans do not result in an "undue concentration of resources". It is not immediately clear to us the extent to which the factor of undue concentration differs from the factor of "decreased or unfair competition". Our only real clue is the Conference Report's statement that

> [t]he dangers of undue concentration of resources include, but are not limited to, specific competitive effects, which are themselves relevant factors under the Act.

1970 U.S.Code Cong. & Adm.News at pp. 5567-68. We gather from this that Congress believed that concentration of economic resources in a single entity beyond a certain point was harmful regardless of the proven existence of any anticompetitive effects of such concentration.

The Board's finding on this issue must be upheld. There can be no doubt either that the insurance businesses of

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[26] The NAIA parties also argue that a finding of likely voluntary tying was mandated by testimony of a Southern officer that, in commercial lending situations only, the borrower's insurance arrangements are scrutinized prior to the closing of the loan. The purpose of such inquiry is to make sure that the proper coverage has been arranged, in order to prepare major loan proposals for comprehensive scrutiny of a loan committee. The officer who testified on this matter added that the necessary insurance often has been obtained by the time the proposal has been brought to the bank. In light of this fact, we cannot say that the number of instances in which the possibility of voluntary tying is increased is sufficiently large to require rejection of the Board's conclusion.

the holding company affiliates will be relatively large or that the holding companies control a substantial amount of the banking resources in the relevant markets. But, as the NAIA itself emphasizes, the insurance agency business is one that is, in general, quite unconcentrated and one in which entry barriers are low. We note also that neither Southern nor First National subsidiaries are the largest banking entities in all but two of their respective markets. In view of the Board's presumed expertise on this area and the fact that the determination of what is "undue" concentration of resources was primarily committed to the Board by Congress, we find that the Board must be upheld.

F. *Conflicts of Interest*

In the Alabama case, the Administrative Law Judge found that there was a reasonable possibility of conflicts of interest in the sale of surety bonds; the Law Judge believed that, since a line of credit is a prerequisite for such a bond, holding companies might grant or withhold credit on the basis of whether the customer had agreed to obtain the surety bond from their insurance affiliate. With respect to other types of insurance in the Alabama case, and with respect to all insurance involved in the Georgia case, the Law Judge found that there were no likely conflicts of interest other than those inherent in any sale of insurance where income is based on the amount of insurance sold. The Board found specifically that there was no credible evidence in the record that would support the finding as to surety bonds. The Board also found that the evidence did not indicate that the holding company banks would make undesirable loans to sell insurance and that regulatory supervision of banks would limit any misconduct of that type.

We are satisfied with the Board's conclusions on these issues. Evidence in the record indicates that the insur-

ance company affiliates will not be run on a pure profit maximization basis, and there is no evidence which would compel the opposite conclusion for which the NAIA parties contend. Contrary to the argument of the NAIA parties, the fact that a holding company's interests as lender and as insurer do not totally converge does not require the conclusion that conflicts of interest will occur. The Board was entitled to credit the evidence that the insurance operations will be viewed as separate from and as an adjunct to the bank lending operations. While it would have been helpful for the Board to respond more fully to the Administrative Law Judge's finding with respect to surety bonds, it is sufficient that the Board did recognize the Law Judge's finding and indicate the source of its disagreement.

In summary, we find that the Board's conclusions with respect to efficiency gains and greater convenience are not supported by substantial evidence, but that its other findings are. Accordingly, the Board properly found one type of public benefit, in the form of increased competition, and no adverse effects on the public interest. The Board's overall finding, that public benefits outweigh adverse effects of granting the applications, can therefore be upheld.

V. Other Issues

A. *Georgia and Alabama Law and the Specificity of Southern's Proposal*

The NAIA parties also contend that the Board gave insufficient consideration to a recently passed Georgia statute which, in essence, prohibits all lending institutions in sizable Georgia communities from selling insurance (other than credit life, accident, or health insurance). Ga. Code Ann. § 56-322 (Supp. 1976). This statute, it is argued, indicates a public policy in the state against the

very type of activity which the Board was asked to approve. We find the Board's response convincing: the statute by its own terms exempts lending institutions like First National and its larger competitor, Citizens & Southern Holding Company, from the prohibition through a grandfather clause. *Id.* § 56-322(d). Because of the clear exemption of First National from the statute, it cannot be said that either the letter or the policy of the Georgia statute warrants rejection of the First National application.

The NAIA parties also argue that the Board improperly failed to consider the effect of an Alabama law providing that only licensed insurance agents may take applications for insurance or place insurance for others. Ala. Code T. 28A, § 119(a) (Supp. 1974). Since Southern's plan contemplated that only a single agent at its central insurance office would be licensed, there is a strong argument that the reference of bank customers to the agent by loan officers and the compilation of insurance information by the loan officers would be illegal. The Board's opinion did not specifically mention the licensing statute, but apparently assumed that the information for insurance applications would be taken by licensed agents rather than by loan officers, a conclusion which seems to have little support from Southern's own witnesses.

Our resolution of this issue is closely tied to that concerning another NAIA claim, that the Southern proposal was impermissibly vague and unformed. The reason for this connection is that the testimony of Southern's witnesses made clear that the precise procedures by which insurance would be placed and applied for had not been clearly established by Southern. *See* II App. 232-35, 244; III App. 718-19. In this area as in others, we recognize that each side presents reasonable arguments. The NAIA parties are entitled to have a fairly specific proposal to

challenge. Only then do they have a reasonable opportunity to protect their economic interests, which obviously are at stake, and only then can the public interests recognized by Congress in the 1970 Amendments receive realistic protection from the Board and the courts. Yet we can ask of Southern and other applicants only that which is reasonably possible. Where, as here, the holding company seeks to enter, *de novo*, into a type of activity with which it has no previous experience, it is wholly understandable that procedures for carrying on the activity may not have been codified in every detail. Indeed, in view of the difficult adjustments involved in entering a new business, particularly one which is heavily regulated, it may be the wisest policy to resist an early total commitment to one or another mode of operation.

Where the balance between these competing interests in specificity and flexibility should be struck is itself a question on which the Board must be considered to have some expertise. It knows far better than this court the time periods which applicants realistically may have to prepare their proposals, the amount of money which they can be expected to invest in them, and the degree of specificity which is inherently possible in each case. Indeed, there are no statutory or constitutional standards, other than those of due process, by which we can make these judgments. Accordingly, we believe that the matter is committed to the Board's discretion and that we can overrule the Board on the issue of specificity only where there is a clear abuse of discretion or where there is a violation of due process. In view of the general specificity of Southern's proposal and its lack of previous experience in insurance agency activities, we find neither in its failure to specify the details of proposed interaction between its banking and insurance operations.

With respect to the particular issue of licensing, we note that Southern acknowledged that its proposed procedures were less than fully fleshed out and repeatedly assured the Board that it would abide by all applicable licensing requirements. *See* III App. 718. Confident that the NAIA parties will scrutinize the Southern operation to ensure such compliance, we feel constrained to uphold the Board in its apparent assumption that Southern will operate not precisely as its witnesses suggested, but in a manner that will comply with Alabama law. To deny the Board the power to make this reasonable assumption would surely forfeit the benefits of the administrative process in terms of flexibility and common sense. We see no necessity for doing so.

B. *Exclusion of Testimony*

The NAIA parties complain of the Administrative Law Judge's exclusion of portions of a 128 page written statement by Harry Houghton, an expert in the area of consumer finance. Part I of the statement dealt with the unique characteristics of banking and the market environment in which it is carried on, while Part II dealt with the nature of credit life and health insurance and the experience of lenders with the sale of such insurance. The Law Judge, who was upheld by the Board, concluded that the testimony was cumulative of the testimony of other witnesses (including Houghton's oral testimony), was largely irrelevant to the issues in the proceedings, and primarily concerned credit life and health insurance, which the parties agreed was a permissible holding company activity. It was noted also that Mr. Houghton had submitted Part I to the Board in a previous proceeding.

So long as an administrative agency is not arbitrary, it has some discretion in determining whether to admit expert evidence. *National Airlines* v. *CAB*, 116 U.S. App. D.C. 114, 321 F.2d 380 (1963). This is particularly true with respect to evidence like that comprising Part I

of Mr. Houghton's statement, which is general and not directed to the specific controversy at hand. *American Trucking Ass'ns, Inc.* v. *F. C. C.*, 126 U.S. App. D.C. 236, 377 F.2d 121 (1968). And it is permissible to reject that portion of the proffered evidence which has previously been accepted by the agency from the same party, *Warren Co.* v. *NLRB*, 353 F.2d 494 (1 Cir. 1965), *cert. denied*, 383 U.S. 958, 86 S.Ct. 1222, 16 L.Ed.2d 300 (1966). For all of these reasons, the exclusion of Part I of Mr. Houghton's testimony was clearly proper.

Although the Board was correct in noting that the permissibility of the sale of credit life and health insurance was not a serious issue in these cases, the experience of lenders with that insurance was arguably relevant to the assessment of the likely public benefits and adverse effects of holding company activities with respect to other types of insurance. Particularly because of the dearth of relevant data upon which to base that assessment, it might have been preferable for the Administrative Law Judge to permit admission of that part of the statement. But we are unprepared to say that the action was so erroneous and prejudicial as to require reversal. As the NAIA parties themselves have strenuously asserted before us, credit life and health insurance differ from the types of insurance primarily involved in this case in several significant ways: they do not involve an insurance decision by the agent but are sold at a uniform low rate and, unlike property and liability insurance, are sold only because of an extension of credit. Because of these differences, which limit sharply the relevance of the experience with credit insurance to these cases, we cannot say that the Law Judge and the Board abused their discretion in excluding Part II of Mr. Houghton's statement.

To summarize, we conclude that:

(1) we have jurisdiction to review § 225.4(a)(9) of Regulation Y;

(2) § 225.4(a)(9) is procedurally valid;

(3) § 225.4(a)(9)(i) (except insofar as it authorizes the brokering of insurance for bank subsidiaries of bank holding companies, (ii)(*c*), and (iii) are invalid because of conflict with § 4(c)(8) of the Bank Holding Company Act;

(4) § 225.4(a)(9)(ii)(*a*) and (*b*) are valid;

(5) the Board's orders in these cases are valid insofar as they authorize the sale of insurance for bank subsidiaries of the holding companies, property damage insurance, liability insurance, and other types of insurance authorized by the Board under § 225.4(a)(9)(ii)(*a*) and (*b*);

(6) the Board's conclusion that expected public benefits outweigh possible adverse effects is supported by substantial evidence;

(7) the Board did not err in its consideration of state law or in accepting Southern's proposal despite its lack of specificity;

(8) the Board did not commit reversible error in excluding portions of the statement of Mr. Houghton.

AFFIRMED IN PART AND REVERSED IN PART.

APPENDIX B

First Rehearing Opinion of the United States Court of Appeals for the Fifth Circuit

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UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Nos. 74-2981, 74-3544 and 74-3843

ALABAMA ASSOCIATION OF INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

GEORGIA ASSOCIATION OF
INDEPENDENT INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

NATIONAL ASSOCIATION OF INSURANCE AGENTS, INC.,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

Jan. 10, 1977

On Petitions for Review of Orders of the Board of Governors of the Federal Reserve Board (Alabama, Georgia and Georgia Cases, respectively).

ON PETITIONS FOR REHEARING AND PETITIONS FOR REHEARING EN BANC

(Opinion June 10, 1976, 533 F.2d 224, 5th Cir. 1976)

Before TUTTLE, THORNBERRY * and CLARK, Circuit Judges.

PER CURIAM:

Petitioners complain that we approved the Board's regulation authorizing holding company sales of property damage and casualty insurance in connection with extensions of credit by "a bank or bank-related firm," yet recognized that the brokering of insurance to non-bank holding company subsidiaries could not pass the closely-related-to-banking test. This criticism is justified. Our opinion is modified to approve the regulation's authorization for sales of property damage and casualty insurance only as it relates to such sales to bank subsidiaries of the holding company. Thus § 225.4(a)(9)(ii)(a) & (b) is invalid to the extent it purports to authorize the sale of property damage or casualty insurance with respect to extensions of credit or the provision of other financial services by holding company subsidiaries which are not banks.

The Board petitions for rehearing as to that portion of our opinion dealing with § 225.4(a)(9)(iii)(a) which denied to holding company agencies the authority to sell any insurance sold in a community that has a population not exceeding 5,000. In its petition the Board represents that substantial factual grounds exist to meet the tests for closely-related-to-banking set out in *National Courier Association* v. *Board of Governors of Federal Reserve*

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* Judge Thornberry was a member of the panel in our opinion of June 10, 1976, but due to illness did not participate in these petitions for rehearing and petitions for rehearing en banc. These cases are being decided by a quorum. 28 U.S.C. § 46(d).

System, 170 U.S.App.D.C. 301, 516 F.2d 1229 (1975), which we adopted to govern our decision here. The petitioners have responded to the Board's assertions with contentions that the regulation does not in fact facilitate the financing of small town banking institutions and could permit insurance operations other than those which the Board's assertions assume.

Upon consideration of said petitions and responses, we vacate the final four complete paragraphs of Part II of our opinion and pretermit any ruling on the merits of this issue in the present appeal. Before the Board implements § 225.4(a)(9)(iii)(a), it must support that part of its regulation with further findings which establish the necessary close relationship of banking to general insurance agency activity in towns with populations not exceeding 5,000. Any such findings by the Board should not only be concerned with whether such full line insurance agency activity is needed to facilitate the financing of banking, but also whether the size of the bank holding company involved would affect the need for such financial support and whether the present wording of the regulation would permit remote insurance agency activity not truly intended to be authorized by the small town exception so that adequate consideration is given to any necessity for limiting the reach of the regulatory language.

In all other respects, the petitions for rehearing filed by petitioners and respondent are denied; and no judge in regular active service on the court having requested that the court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12), the petitions for rehearing en banc are denied. This court does not retain jurisdiction of the appeal.

APPENDIX C

Second Rehearing Opinion of the United States Court of Appeals for the Fifth Circuit

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UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

Nos. 74-2981, 74-3544 and 74-3843

ALABAMA ASSOCIATION OF INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

GEORGIA ASSOCIATION OF
INDEPENDENT INSURANCE AGENTS, et al.,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

NATIONAL ASSOCIATION OF INSURANCE AGENTS, INC.,
Petitioner,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

Sept. 1, 1977

On Second Petitions for Rehearing and Second Petition for Rehearing En Banc.

Before TUTTLE, THORNBERRY, and CLARK, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the first full paragraph of the Slip Opinion of the Court dated January 10, 1977, on the first petitions for rehearing and first petitions for rehearing en banc, be withdrawn and the following language be substituted:

> Petitioners point out that in approving the Board's regulation authorizing holding company sales of property damage and liability insurance in connection with extensions of credit by "a bank or bank-related firm," we failed to make clear whether such insurance could properly be provided by non-bank holding company subsidiaries as well as bank subsidiaries. This observation is correct; however, we reject petitioners' contention that the sale of property damage and liability insurance should be restricted to subsidiaries which are banks. On the contrary, we find that the provision of property damage and liability insurance in connection with the traditional banking-type functions of extending credit and providing other financial services is "closely related to banking." Whether the banking-type services and related insurance are provided by a bank or a non-bank subsidiary of a bank holding company is irrelevant. Thus, we clarify our original opinion by holding that the Board's regulation 225.4(a)(9)(ii)(a) & (b), authorizing the sale of property damage and liability insurance in connection with extensions of credit and other financial services, is valid with regard to such sales by both bank and non-bank subsidiaries of bank holding companies.

In all other respects, the second petitions for rehearing are DENIED and no member of this panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, (Rule 35 Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the Second Petition for Rehearing En Banc is DENIED.

APPENDIX D

Judgment of the United States Court of Appeals for the Fifth Circuit

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UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1975

Nos. 74-2981, 74-3544 & 74-3843

Your No. 12 U.S.C. 1848

ALABAMA ASSOCIATION OF INSURANCE AGENTS, et al.,
Petitioners,

versus

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

GEORGIA ASSOCIATION OF
INDEPENDENT INSURANCE AGENTS, et al.,
Petitioners,

versus

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

NATIONAL ASSOCIATION OF INSURANCE AGENTS, INC.,
Petitioner,

versus

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

Petitions for Review of Orders of the Board of Governors of the Federal Reserve System (Alabama, Georgia and Georgia Cases respectively)

Before TUTTLE, THORNBERRY and CLARK, Circuit Judges.

JUDGMENT

These causes came on to be heard on the petitions of Alabama Association of Insurance Agents, et al., Georgia Association of Independent Insurance Agents, et al., and National Association of Insurance Agents, Inc. for review of orders of the Board of Governors of the Federal Reserve System and were argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the orders of the Board of Governors of the Federal Reserve System in these causes be, and the same are hereby, affirmd in part and reversed in part;

It is further ordered that petitioners pay to respondent and intervenors-respondents, the costs on appeal to be taxed by the Clerk of this Court.

June 10, 1976

Issued as Mandate:

APPENDIX E

Order of the Board of Governors of the Federal Reserve System

FRB Docket IA-10

(Southern Bancorporation)

FEDERAL RESERVE SYSTEM

THE ALABAMA FINANCIAL GROUP, INC.

Order Approving Application to Engage *De Novo* In Certain Insurance Agency Activities

The Alabama Financial Group, Inc.,[1] Birmingham, Alabama ("Applicant"), a bank holding company within the meaning of the Bank Holding Company Act, on February 24, 1972, applied to the Federal Reserve Bank of Atlanta for approval, under § 4(c)(8) of the Act, as amended, and § 225.4(a)(9) of the Board's Regulation Y (12 CFR 225.4(a)(9)), to engage *de novo* in certain insurance agency activities at various locations in Alabama at which Applicant or its banking and bank-related subsidiaries are otherwise engaged in business, through an insurance agency subsidiary ("Agency") to be formed by Applicant.

Applicant proposes through Agency to act as insurance agent or broker with respect to:

1. All insurance for Applicant and its subsidiaries.
2. Any insurance to protect assets financed by Applicant and its subsidiaries and other insurance calculated to protect the lender's ability to obtain repayment of loans including:

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[1] In April, 1974, Applicant's corporate name was changed to Southern Bancorporation.

a. fire and extended coverage insurance
b. use and occupancy insurance
c. business interruption insurance
d. liability insurance
e. homeowners insurance
f. performance bonds connected with construction loans
g. boiler and machinery insurance
h. fidelity insurance
i. theft insurance
j. collision and comprehensive insurance
k. surety bonds
l. marine property insurance

3. Any insurance the purpose of which is to provide loan or repayment funds in the event of loss of income or other inability to repay debt including:
   a. credit life and credit accident and health insurance
   b. mortgage life or mortgage guaranty insurance
4. Convenience insurance within the limitations of Regulation Y.
5. A full line of general insurance at offices located in communities having less than 5,000 population.

Applicant proposes to sell such insurance only in connection with extensions of credit or the provision of other financial services, or as a matter of convenience to the purchaser within the limits of Regulation Y, or in connection with less than 5,000 population. The sale of certain types of insurance is an activity that has been determined by the Board to be closely related to banking (12 CFR 225.4(a)(9)).

Notice of the application was published in the communities to be served in accordance with § 225.4(b)(1) of the Board's Regulation Y. Objections to the applica-

tion, requesting a hearing and seeking permission to intervene, were filed by the National Association of Insurance Agents ("NAIA"), the Alabama Association of Insurance Agents ("AAIA"), the Independent Insurance Agents of Birmingham ("IIAB"), and U.S. Fidelity and Guaranty Company ("USF&G"). On March 29, 1972, the Federal Reserve Bank of Atlanta stayed the proceeding and requested that the Board act directly on the application.

By order dated March 6, 1973, the Board directed that a formal hearing be held on the subject application, as well as 21 other pending applications by bank holding companies to engage in certain insurance agency activities (38 *Federal Register* 6441), before a designated Administrative Law Judge ("Law Judge"). In addition to the parties designated above, other parties sought and were granted permission to participate in the proceeding, including the American Bankers Association ("ABA"), National Association of Casualty & Surety Agents ("NACSA"), and the Committee to Preserve Consumer Options ("CPCO"), an association of 28 banking institutions including most of the applicant bank holding companies in other docketed insurance agency applications then pending before the Board.

Following a prehearing conference in Washington, D.C., on March 27, 1973, a public hearing was held on this application in Atlanta, Georgia, on June 25-26, 1973.[2] The hearings and related proceedings have been conducted in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR 263).

In a Recommended Decision of February 7, 1974, the Administrative Law Judge concluded that the evidence

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[2] Board counsel participated in the hearing in a nonadversary capacity but took no position with respect to the merits of the application (12 CFR 263.6(d)).

supported a partial approval of the application and recommended:

(1) That the application of the Alabama Financial Group be granted with respect to proprietary and employee insurance and for credit life, health and accident and mortgage redemption insurance but denied as to all other forms of insurance in Birmingham, Dothan and Marion County, Alabama.

(2) That the application be granted as to credit-related insurance agency sales except surety bonding to customers of banking and nonbanking affiliates located in Huntsville, Mobile and any other area in which a banking subsidiary may be acquired in which said subsidiary controls less than 15 per cent of local deposits.

(3) That, in those respects in which the application is granted, the authorization be subject to appropriate anticoercion statements to be furnished for execution by loan/insurance customers as part of their applications.

The Board, having considered the exceptions taken to the Recommended Decision by the various parties and the entire record, and having determined that the Administrative Law Judge's findings of fact, conclusions, and order, as modified and supplemented herein, should be adopted as the findings, conclusions, and order of the Board, now makes its findings as to the facts, its conclusions drawn therefrom, and its order.

Applicant controlled four banking subsidiaries as of December 30, 1972, with aggregate deposits of $676.8 million. These subsidiaries were located in Jefferson, Houston, Madison and Mobile Counties. Applicant predicts that its proposed agency will generate approximately $200,000 in annual premiums from the requirements of the holding company and its subsidiaries, and

approximately $600,000 in annual premiums from the sale of credit life and credit accident and health insurance. Applicant stated that it was unable to make reasonable projections of premium income from the sale of other types of insurance.

The principal issues before the Board that arise from this application are: (1) whether the proposed insurance agency activities are permissible activities under § 225.4 (a) (9) of Regulation Y and are therefore so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto; (2) whether performance of the proposed activities can reasonably be expected to produce benefits to the public such as greater convenience, increased competition, or gains in efficiency, and (3) whether such benefits to the public outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices. The Board has previously determined by Regulation (12 CFR 225.4(a)(9)) that the following activities are so closely related to banking or managing or controlling banks as to be proper incident thereto.[3]

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[3] The Board's Insurance Regulation was adopted after notice of proposed rule-making and following receipt of comments on the substance of the proposed regulation. The insurance activities authorized by the regulation are those that are organizationally and physically integrated into the operations of the bank holding company. The Board's decisions in this area prior to the 1970 Amendments to the Act are generally to the same effect (see, for example, Otto Bremer Company 1959 *F.R. Bull.* 892; First Bank Stock Corporation 1959, *F.R. Bull.* 917; and United Virginia Bancshares, Inc., 1970 *F.R. Bull.* 599.)

Members of both houses of Congress referred to the Board's prior decisions during the legislative debate to the 1970 amendments. A member of the Conference Committee, Senator Bennett, stated: "The Federal Reserve Board under the existing language of § 4(c)(8) for the past 14 years has approved insurance activities for bank holding companies and there was no intent on the part of the Conference Committee to overrule these past decisions". Congressional Record S20645, December 18, 1970.

(9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:

(i) Any insurance for the holding company and its subsidiaries;

(ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);

(iii) Any insurance sold in a community that (a) has a population not exceeding 5,000 or (b) the holding company demonstrates has inadequate insurance agency facilities.

Upon reviewing the legislative history to the 1970 Amendments to the Bank Holding Company Act, the Law Judge concluded that "the Congress clearly had credit-related insurance agency sales in mind as an enterprise closely related to banking subject, however, to surviving the gamut of a net public benefits test. . . ." page 17. The Board's own understanding of the legislative history to the 1970 Amendments is consistent with that of the Law Judge and formed the basis upon which the above-described Insurance Regulation was promulgated. Although no precise guidelines were given the Board for making its determination of those activities which are

closely related to banking, the legislative history of the 1970 Amendments to the Bank Holding Company Act include, as the Law Judge noted, references to sales of credit-related insurance as examples of activities closely related to banking. The Law Judge's review of the legislative history was described fully in companion Recommended Decisions[4] to which he referred in his Recommended Decision in the instant matter. Indeed, in a companion Recommended Decision issued November 9, 1973, the Law Judge found that "the business of selling general insurance" was an activity so closely related to banking as to be a proper incident thereto. However, the Applicant in this proceeding has not sought the Board's prior approval to operate a general insurance agency. Instead, Applicant listed in its application those specific insurance coverages it contemplated selling and for which prior Board approval is sought.

The insurance Applicant seeks to sell under No. (1) above (all insurance for Applicant and its subsidiaries) has been specifically permitted under § 225.4(a)(9)(i) of the Board's Insurance Regulation. By a published Interpretation to this Regulation, the Board has further indicated that it regards the sale of group insurance for the protection of employees of the holding company as insurance for the holding company and its subsidiaries within § 225.4(a)(9)(i). However, NAIA argued that the sale of group insurance and fidelity insurance on employees would not be closely related to banking where the employees pay part of the premiums. Regardless of which party pays the premium, the Board views the protection of a bank holding company's employees through group insurance as a distinct benefit to the holding company itself. Thus, the provision of group insurance pro-

[4] Recommended Decisions Docket Numbers IA-3, 6, 7, 12, and 13 issued November 9, 1973, pp. 15-22; Docket Numbers IA-8, pp. 9-16 issued January 14, 1974.

tecting a holding company's employees is no less "for the holding company" than would be insurance on real property owned by the holding company. Accordingly, the Board finds that the sale of insurance for the holding company and its subsidiaries, including group insurance for the protection of employees of Applicant, to be a permissible activity under § 225.4(a)(9)(i) of the Insurance Regulation.

Applicant seeks to sell various forms of insurance under No. (2) above that protects the collateral in which a subsidiary has a security interest as a result of an extension of credit. Included among these coverages are physical damage insurance on real estate and physical damage insurance on personal property. Applicant contends, and the Board so finds, that such coverages are directly related to an extension of credit within the meaning of § 225.4(a)(9)(ii)(a) of the Insurance Regulation. The extension of credit on a secured loan is founded upon the value of the collateral securing the loan. Thus, insurance is essential from the lender's standpoint to assure that the value of the collateral will not be impaired by physical damage. The financial nature of the insurance transaction forms an integral function for the borrower as well, since the presence or lack of insurance protecting loan collateral is an essential element of the credit evaluation. The evidence of record confirms, in the Board's view, that the sale of insurance protecting the collateral securing an extension of credit is directly related to such extension of credit. The Board notes further that this finding is in accord with its previously published Interpretation (12 CFR 225.128) pertaining to insurance that supports the lending transactions of a bank or bank-related firm in the holding company system.

Applicant also seeks Board approval to sell liability insurance on both real and personal property, as described above, when a subsidiary has taken a security interest in such property as the result of an extension of credit. It appears from the evidence of record that liability insurance is generally sold in conjunction with or as part of an insurance package with insurance that protects the collateral securing an extension of credit. Thus, a "packaged" insurance policy, combining liability insurance with insurance relating to physical damage on property purchased from loan proceeds, fulfills a legitimate need of the lender and borrower alike at the time a loan is made. Moreover, in the case of homeowner's insurance, it appears that it would not be economical for a borrower to procure separately the various coverages customarily packaged in such a policy. The Board concludes from all the evidence of record that the sale of liability insurance on both real and personal property supports the lending transactions of a bank or bank-related firm in the holding company system when it is sold to borrowers in conjunction with or as part of an insurance package with insurance protecting the collateral in which the bank or bank-related firm has a security interest and is a permissible activity within § 225.4(a)(9)(ii)(a) of the Insurance Regulation.

Applicant has also requested permission to sell surety bonds. Such bonds would include bid bonds (guaranteeing a successful bidder on a building contract will enter into the contract), subdivision bonds (guaranteeing to a municipality that the builder will make all required improvements) and completion or performance bonds (insuring against a maintenance contractor's failure to maintain its obligation under a maintenance agreement). The procurement of the coverages involved through surety bonds has traditionally been a part of a mortgage loan transaction. In the Board's judgment, a direct relationship exists between the sale of surety bonds and an extension of credit. Accordingly, the sale of surety bonds

is, in the Board's view, an activity within § 225.4(a)(9)(ii)(a) of the Insurance Regulation.

The Board finds, with three exceptions, that the several types of insurance listed under No. (2) above are either property insurance or liability insurance sold as part of a package with property insurance on assets financed by Applicant and therefore within § 225.4(a)(9)(ii)(a) of the Insurance Regulation. The exceptions are (1) use and occupancy insurance, (2) business interruption insurance, and (3) fidelity insurance. Little or no evidence was presented concerning these types of insurance. Accordingly, there is insufficient evidence in this record upon which the Board may conclude that any of the insurance noted in the exceptions above fall within § 225.4(a)(9)(ii)(a) or (b) of the Insurance Regulation.

Applicant has requested prior Board approval to engage in the sale of credit life, credit accident and health, mortgage redemption and mortgage guaranty insurance. With the exception of mortgage guaranty insurance, the Board has previously determined by order [5] that the sale of these forms of insurance was so closely related to banking as to be a proper incident thereto within the meaning of § 225.4(a)(9) of the Insurance Regulation. The previous findings of the Board concerning such coverages are reaffirmed herein since such insurance is often required to assure repayment of an extension of credit by the holding company system in the event of death or disability of the borrower. Under these conditions, the Board finds that the sale of such insurance is directly related to an extension of credit. Mortgage guaranty insurance is a form of credit risk insurance that serves

[5] See Board Order of January 28, 1974, granting approval to Worcester Bancorp, Inc., Worcester, Massachusetts, to engage *de novo* in the sale of credit life, credit accident and health, and mortgage redemption insurance (1974 *F.R. Bull.* 393).

to protect the lender against loss of a specified percentage of a loan in the event of foreclosure and sale of collateral. In this respect, it may be likened to mortgage redemption insurance. The Board therefore concludes that the sale of mortgage guaranty insurance is also within § 225.4(a)(9)(ii)(a) of the Insurance Regulation.

Applicant also requests permission, under No. (4) above, to sell insurance that is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this category does not constitute a significant portion of the aggregate insurance premium income from insurance sold in connection with loans or other financial services. The sale of such insurance has been expressly permitted by the Board under § 225.4(a)(9)(ii)(c) of the Insurance Regulation. The Board does not regard this provision as being designed to permit entry into the general insurance agency business, but only permits the limited sale of such insurance as a matter of convenience to the purchaser.

Finally, Applicant has applied to sell general insurance at offices located in communities with a population not exceeding 5,000. This request is clearly within § 225.4(a)(9)(iii)(a) of the Insurance Regulation. One of the communities affected under this request is the community of Hoover, Alabama. It is clear that the population of Hoover does not exceed 5,000. The fact that Hoover is situated within the Birmingham Standard Metropolitan Statistical Area ("SMSA") does not prevent this community from qualifying under the provisions of § 225.4(a)(9)(iii)(a) of the Insurance Regulation. The provisions of 12 U.S.C.A. § 92, pertaining to the powers of a national banking association to engage in the insurance business in a community the population of which does not exceed 5,000 inhabitants, contain no such limitation. Accordingly, the Board concludes that the sale of general insurance in communities with a population not exceed-

ing 5,000, including the community of Hoover, is a permissible activity within the Insurance Regulation.

In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the 1970 Amendments to the Act require the Board to "consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices". Each of these factors has been separately considered by the Board in its determination herein.

In the Board's view, it is reasonable to anticipate that approval of the subject application will result in a benefit to the public in terms of greater convenience to the borrower. The ability of a borrower to complete an entire credit-insurance transaction at one location is likely to result in a considerable savings in time as well as eliminate the duplication of certain informational requirements. Moreover, it appears from the record that borrowers have often requested insurance from Applicant's banks in the past, and there is a present demand for this added convenience. Although Applicant will initially have but one licensed agent at the head office of its lead bank, there would appear to be some convenience, although to a lesser degree, for borrowers at Applicant's other banking locations. Applicant intends to have its loan officer contact the licensed agent to permit the latter to obtain the necessary information to complete the insurance transaction. The Board therefore concludes that approval of the instant application would bring greater conveniences to the public, and that this factor supports approval of the application.

Approval of the subject application is also likely to result in some gains in efficiency. Most of the policies sold must, by Board Regulation, be directly related to an extension of credit or the provision of other financial services offered by Applicant. Thus, some savings can be anticipated through the reduction or even elimination of advertising and solicitation expenses as the agent's customers will normally be referred to him by loan officers. Efficiencies are also likely to result through Applicant's ability to combine its insurance and loan billing operations. It is the Board's judgment that such efficiencies will result in positive public benefits in terms of the service Applicant will be able to offer its borrower-insureds.

It is reasonable to anticipate some increased competition among insurance agents in Alabama. While it does not appear that Applicant can introduce more than a minimum amount of price competition in those insurance agency markets that Applicant enters, it would appear capable of injecting strong competition in such markets on the basis of service. The added convenience of completing a credit-insurance transaction at one location, discussed supra, is one of the competitive means whereby Applicant may improve its service to the public. The ready availability of the financial expertise which Applicant brings to its borrower-insured will offer a new dimension to the competitive scene. In addition, certain technical efficiencies in the data processing area give Applicant the capability of competing effectively with independent agents. Based on these and other facts of record, it is the Board's judgment that approval of the subject application will produce public benefits through increased competition among insurance agents in local Alabama markets.

One of the possible adverse effects which Congress directed the Board to consider in determining whether a

particular activity is a proper incident to banking or managing or controlling banks is the danger of an undue concentration of resources. As noted in the Conference Report accompanying H.R. 6778, this particular danger "is enhanced when concentrations of power are centered about money, credit and other financial areas, the common denominators of the economy." The share of commercial bank deposits Applicant's banking subsidiaries hold in local Alabama markets does not establish an undue concentration of resources in those markets. It appears from the record in this proceeding that there are numerous banking alternatives in Alabama's banking markets. Moreover, additional competition in individual markets has resulted from the expansion of the State's bank holding companies. Thus, the Board concludes that the danger of an undue concentration of resources which the Congress feared might arise from bank holding company entry into a particular nonbanking activity is not present in this proceeding. Accordingly, Applicant's *de novo* entry into the sale of those insurance coverages the Board has found to be closely related to banking will not disturb the present competitive relationships in Alabama's local banking markets.

Another possible adverse effect which the Congress directed the Board to consider in any § 4(c)(8) application concerned the danger of decreased or unfair competition. Since the Law Judge found in his Recommended Decision that Applicant's sale of the above-described insurance coverages would encourage a practice of "voluntary tying," he concluded that Applicant would possess an unfair competitive advantage. Accordingly, the Law Judge recommended that Applicant not be permitted to sell insurance in markets where its banking subsidiaries hold more than 15 per cent of the total deposits in commercial banks. However, the evidence of record contains no specific instances of a tying arrangement resulting

from either coercion or through a form of market power that could lead to "voluntary tying." On the other hand, there was testimony by Applicant's witness that insurance was not discussed until after a loan had been closed with the possible exception of commercial loans. This would lessen any presumed pressure on borrowers to tie their purchase of insurance to their borrowing of funds. Also, penetration figures for a bank-related insurance agency in North Carolina indicate that a very low percentage of sales of insurance relative to total loans was obtained by that agency. The Board notes that the concentration of deposits in commercial banks in Alabama is not significantly different from that in North Carolina and that it is therefore reasonable to anticipate a comparatively low penetration of insurance sales relative to total loans for Applicant.[6]

Additionally, lenders other than commercial banks operate in most of the local markets in Alabama in which Applicant wishes to sell insurance. For example, borrowers can obtain automobile loans from sales finance companies, personal loans from consumer finance companies and credit unions, and mortgage loans from savings and loan associations and mortgage bankers. Considering these nonbank sources of credit together with the several banking alternatives available in local markets in Alabama, the Board concludes that Applicant's entrance into the insurance business will not create a possible danger of voluntary tying by borrowers of their insurance needs to their loans.

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[6] There is not a one-to-one relationship between an amount of penetration and an amount of voluntary tying in a particular context. Rather, a given penetration figure determines the maximum amount of voluntary tying that can possibly exist. If the penetration figure is low, as is the evidence presented from North Carolina, then the voluntary tying figure will be low. The converse is not true; a high penetration figure does not by itself indicate a high amount of voluntary tying.

It is clear from this evidence of record that Applicant does not possess that degree of market power sufficient to create the danger of voluntary tying or that such a practice could become a realistic threat. In view of the evidence of record concerning the fear of voluntary tying, discussed supra, the Board does not believe it should adopt an arbitrary standard which would foreclose Applicant from selling insurance in areas where its banking subsidiaries possess more than 15 per cent of deposits in commercial banks. Such a standard would prevent Applicant's sale of insurance in many markets thereby negating the convenience and benefits the Board has found exist. The public would not be served well in that case. Accordingly, it is the Board's judgment that approval of the subject application will not result in decreased or unfair competition.

The Law Judge recommended in his decision that "appropriate statements be included in all insurance application forms furnished by affiliates of the Applicant, in bold type above the borrower's signature, to the effect that the customer understands the placement of such insurance is not offered as a condition to the grant of credit, nor is an inducement therefor. . . ." The Board finds that the evidence in this record is not sufficient to require such language.

The Law Judge also recommended as a condition of approval that language be added to insurance application forms indicating that "similar insurance, not necessarily naming the lending institution as beneficiary, may be obtained from independent agents or in lieu thereof, that existing insurance owned by the debtor may be assigned to the bank" (page 20). The Board has not required this specific condition before and the evidence in this record is insufficient to demonstrate a public need for such a requirement.

In considering the possible adverse effect of conflicts of interests that may arise through Applicant's entry into the proposed insurance agency activities, the Law Judge found that a conflict existed in the "business of surety bonding." A prerequisite that the bond purchaser secure a line of credit from a lender in order to establish his economic solvency in the eyes of the underwriter would tempt the banking affiliate, so the Law Judge found, "to extend the necessary letter of credit even though sound banking practice would not so dictate." The Board does not find any credible evidence of record to support this conclusion. Nor does the record support a conclusion that lending affiliates of the Applicant would risk making an undesirable loan for the purpose of selling the customer any other form of insurance. Regulatory supervision of loans made by banking affiliates of Applicant appears to provide a reasonable safeguard against this possibility. Accordingly, the Board finds that the adverse effects that might arise from possible conflicts of interest are not present in this application. In addition, a review of the entire record indicates that no other unsound banking practices would result from Applicant's entry into the sale of the specified insurance coverages. Therefore, it is the Board's judgment that consummation of the proposed transaction would not result in unsound banking practices.

The Board notes that NAIA has objected to the exclusion by the Law Judge of certain testimony of Mr. Harrison Houghton, a witness for NAIA. The Board, after examining the record, concludes that the Law Judge correctly exercised his discretion in refusing to admit this testimony since it was cumulative to other testimony in the record and, moreover, irrelevant to many of the issues involved in this application.

NAIA filed a motion to exclude Board personnel who were involved in this hearing from participating "in the

making of the Board's decision" on this application. Since such personnel of the Board did not participate in the decisional process, the issue raised by the motion is moot.

Based on the foregoing and other considerations reflected in the record, the Board has determined that the balance of the public interest factors the Board is required to consider under § 4(c)(8) is favorable. Accordingly, the application is hereby approved, subject to the conditions noted above. This determination is further subject to conditions set forth in § 225.4(c) of Regulation Y and to the Board's authority to require such modification or termination of the activities of the holding company or any of its subsidiaries as the Board finds necessary to assure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder or to prevent evasion thereof. The transaction herein approved shall be made not later than three months after the effective date of this Order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Atlanta pursuant to delegated authority.

By order of the Board of Governors,[7] effective July 3, 1974.

(Signed) Chester B. Feldberg

CHESTER B. FELDBERG
Secretary of the Board

[SEAL]

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[7] Voting for this action: Vice Chairman Mitchell and Governors Brimmer, Sheehan, Bucher, Holland and Wallich. Absent and not voting: Chairman Burns.

APPENDIX F

Order of the Board of Governors of the Federal Reserve System

FRB Docket IA-8

(First National Holding Corp.)

FEDERAL RESERVE SYSTEM

FIRST NATIONAL HOLDING CORPORATION

Order Approving Application to Engage In Certain Insurance Agency Activities

First National Holding Corporation, Atlanta, Georgia, a bank holding company within the meaning of the Bank Holding Company Act, has applied for the Board's approval, under § 4(c)(8) of the Act and § 225.4(a)(9) of the Board's Regulation Y, to engage in certain insurance agency activities through a division of Applicant's wholly-owned subsidiary, Tharpe and Brooks, Inc., Atlanta, Georgia. Applicant proposes to act as an insurance agent or broker in respect to the following types of insurance:

1. Any insurance for Applicant and its subsidiaries
2. Any insurance required by a lender to protect the value of an asset being financed by Applicant or its subsidiaries such as autos, boats, mobile homes, campers, and appliances. Insurance sold in this regard would be:
   a. fire, theft and other perils
   b. comprehensive
   c. collision
   d. marine

e. liability
f. property floaters

3. Any insurance required by Applicant or its subsidiaries to protect the value of inventory being financed by Applicant or its subsidiaries. Insurance sold in this regard would be:

   a. property coverage
   b. business interruption
   c. liability

4. Any insurance required to protect the value of an asset being leased where Applicant or its subsidiaries are the lessors. Insurance sold in this regard would be:

   a. property coverage
   b. liability

5. Any insurance required by Applicant or its subsidiaries to protect the value of real estate being financed by Applicant or its subsidiaries, whether acting as principal or agent. Insurance sold in this regard would be:

   a. property coverage
   b. loss of rents
   c. liability
   d. homeowners
   e. performance bonds

6. Any insurance required by Applicant or its subsidiaries to protect the value of business equipment being financed by Applicant or its subsidiaries. Insurance sold in this regard would be:

   a. property coverage
   b. liability

7. Any insurance on the life or health of a borrower or lessee of the Applicant or its subsidiary where

the Applicant or the subsidiary is the beneficiary of the insurance. Insurance sold in this regard would be:

   a. disability income
   b. mortgage life
   c. credit life

8. Any insurance that is otherwise sold as a matter of convenience to the purchaser, such as:

   a. accident health
   b. automobile
   c. property
   d. casualty
   e. life

The sale of certain types of insurance is an activity which has been determined by the Board to be closely related to banking (12 CFR 225.4(a)(9)) and, in general, to offer sufficient public benefits so as to meet the requirements of § 4(c)(8) of the Act.

Notice of the application was published in accordance with § 225.4(b)(2) of the Board's Regulation Y. Objections to the application were filed by certain local independent insurance agencies and by the National Association of Insurance Agents ("NAIA") and the Georgia Association of Independent Insurance Agents ("GAIA"). These parties sought and were granted intervention in the proceeding and requested a hearing thereon.

By Order dated March 6, 1973, the Board directed that a formal hearing be held on the subject application, as well as 21 other pending applications by bank holding companies to engage in certain insurance agency activities before a designated Administrative Law Judge ("Law Judge") (38 *Federal Register* 6441). In addition to the parties designated above, other parties sought and

were granted permission to participate in the proceeding, including the National Association of Life Underwriters ("NALU"), U.S. Fidelity and Guaranty Company ("USF&G"), and the Committee to Preserve Consumer Options ("CPCO") (an association of 28 banking institutions including most of the applicant bank holding companies in other docketed insurance agency applications then pending before the Board).

Following a prehearing conference on March 27, 1973, a public hearing was held in Atlanta, Georgia, commencing on June 27 and closing on June 29, 1973. A substantial record was developed through testimony and exhibits of the parties to the proceedings and others from the banking and insurance communities, both in support of, and in opposition to, the application.[1] The hearing has been conducted in accordance with the Board's Rules of Practice for Formal Hearings (12 CFR 263).

In a Recommended Decision, the Law Judge concluded that the evidence supported a partial approval of the application and recommended:

(1) That the application be granted with respect to proprietary and employee insurance for Applicant and its subsidiaries and for credit life, health and accident, and mortgage redemption insurance for their customers but denied as to all other forms of insurance in the Atlanta, Georgia area.

(2) That the application be granted as to insurance agency sales by First South Insurance Agency Division of Tharpe and Brooks, Inc. at its offices located outside of the Atlanta, Georgia, area and to customers of nonbanking affiliates of First

[1] Board counsel participated in the hearing in a nonadversary capacity and took no position with respect to the merits of the application (12 CFR 263.6(d)).

National Holding Company also located outside the Atlanta, Georgia, area subject to the restrictions as set forth in Regulation Y § 225.4(a)(9).

(3) That, in those respects in which the application is granted, the authorization be subject to appropriate anticoercion statements to be furnished for execution by customers as part of their insurance applications.

The Board, having considered the exceptions taken to the Recommended Decision by the various parties and the entire record, and having determined that the Law Judge's findings of fact, conclusions, and order, as modified and supplemented herein, should be adopted as the findings, conclusions, and order of the Board, now makes its findings as to the facts, its conclusions drawn therefrom, and its order.

Applicant's only banking subsidiary, First National Bank of Atlanta ("Bank") had deposits of $1.0 billion representing about 24.5 per cent of total deposits of commercial banks in the Atlanta Metropolitan Statistical Area.[2] Applicant also controls several nonbanking subsidiaries engaged in such activities as data processing, leasing of personal property and equipment, mortgage banking, factoring, and commercial real estate financing. One of Applicant's nonbanking subsidiaries, Tharpe and Brooks, Inc., was acquired in 1970. This subsidiary is engaged in the activity of mortgage banking and, as of May 31, 1973, serviced loans on property worth $420 million. Applicant proposes to engage in the above-described insurance agency activities through a division of Tharpe and Brooks, Inc. and estimates that during the first year of operation this division should generate approximately $1.5 million in premium income.

[2] All banking data are as of December 31, 1972.

The principal issues involved in this application are identical to those considered by the Board in its July 3, 1974, approval of the application of The Alabama Financial Group, Inc. to engage in certain insurance agency activities (39 *Federal Register* 25548). The Board must determine whether the activities sought to be engaged in by Applicant are: (1) permissible activities within § 225.4 (a) (9) of Regulation Y and therefore closely related to banking or managing or controlling banks and (2) whether performance of the proposed activities can reasonably be expected to produce benefits to the public such as greater convenience, increased competition, or gains in efficiency that outweigh possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices. The Board has previously determined by Regulation (12 CFR 225.4(a) (9)) ("Insurance Regulation") that the following insurance agency activities are closely related to banking or managing or controlling banks and, in general, that performance of these activities by bank holding companies satisfies the public benefits test of § 4(c) (8) of the Act.[3]

> (9) acting as insurance agent or broker in offices at which thc holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:
>
> (i) Any insurance for the holding company and its subsidiaries;

[3] The Board's Insurance Regulation was adopted after notice of proposed rulemaking and following receipt of comments on the substance of the proposed regulation. The insurance activities authorized by the Insurance Regulation are arguably narrower than those insurance activities authorized by the Board prior to the 1970 amendments to the Bank Holding Company Act. These prior decisions of the Board were referred to approvingly by members of Congress in debate on the 1970 Amendments.

> (ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii) (c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);
>
> (iii) Any insurance sold in a community that (a) has a population not exceeding 5,000 or (b) the holding company demonstrates has inadequate insurance agency facilities.

The Law Judge concluded after review of the legislative history to the 1970 Amendments to the Bank Holding Company Act that "the Congress clearly had credit-related insurance agency sales in mind as an enterprise closely related to banking subject, however, to surviving the gamut of a net public benefits test . . ." page 17. The Board concurs with the Law Judge's understanding of the legislative history to this section of the Act and notes that this interpretation formed, in part, the basis for the adoption of the Board's Insurance Regulation. The Board has examined the individual types of insurance that Applicant seeks permission to sell in order to determine whether they come within the terms of the Insurance Regulation and whether their sale by Applicant satisfies the public benefits test.

Applicant seeks to sell under No. (1) above insurance for Applicant and its subsidiaries. Sale of this type of insurance has heretofore been permitted under § 225.4 (a) (9) (i) of the Board's Insurance Regulation. Insurance permissible to sell under No. (1) would include

insurance for the protection of the employees of the holding company in situations where the employee pays a portion of the premium for such insurance. As the Board noted in its Order referred to above relating to the application of The Alabama Financial Group, Inc., the protection of a bank holding company's employees through group insurance is a distinct benefit to the holding company the same as insurance on real property owned by the holding company. Therefore, the Board finds that the sale of insurance for the holding company and its subsidiaries, including group insurance for the protection of employees of Applicant, is a permissible activity under § 225.4(a)(9)(i) of the Insurance Regulation.

Under Nos. (2), (3), (5), and (6) above, Applicant seeks to sell various forms of insurance that protect the collateral that secures an extension of credit by Applicant or its subsidiaries. The Board finds that such coverages are directly related to an extension of credit within the meaning of § 225.4(a)(9)(ii)(a) of the Insurance Regulation. Insurance is essential from the lenders' standpoint to assure that the value of the collateral underlying an extension of credit will not be impaired by physical damage. The evidence of record in this proceeding confirms that the sale of insurance protecting the collateral securing an extension of credit is directly related to such extension of credit.

Applicant also seeks approval under these sections to sell liability insurance with regard to the assets being financed by Applicant or its subsidiaries. It appears from the evidence in this proceeding that liability insurance is generally sold in conjunction with property insurance on collateral securing extensions of credit. The Board has previously determined that where liability insurance is sold as part of a package with property insurance on collateral securing an extension of credit,

the sale of such liability insurance is directly related to an extension of credit within the meaning of § 225.4(a)(9)(ii)(a) of the Board's Insurance Regulation. The Board reaffirms that position herein.

Applicant seeks authority under No. 5(d) above to sell homeowners' insurance. This is also a package form of insurance that combines property insurance with several other types of coverages and comes within § 225.4(a)(9)(ii)(a) of the Board's Insurance Regulation. This conclusion is further confirmed by the evidence of record indicating the difficulty of separately obtaining the several types of coverages contained in a homeowner's policy at a price comparable to that for the package. Accordingly, the Board concludes that the sale of homeowners' insurance supports the lending transactions of a bank or bank-related firm in the holding company system when it is sold to borrowers as a means of protecting the collateral in which the bank or bank-related firm has a security interest and is a permissible activity within § 225.4(a)(9)(ii)(a) of the Insurance Regulation.

Applicant requests authority under No. 5(e) above to sell performance bonds. Performance bonds have traditionally been sold as part of a mortgage loan transaction, and in the Board's judgment, there is a direct relationship between the sale of performance bonds and an extension of credit. The Board, therefore, finds that the sale of performance bonds is an activity within § 225.4(a)(9)(ii)(a) of the Insurance Regulation.

The sale of the several types of insurance sought to be sold under 5(a)(c)(d)(e) is also permissible where Applicant or its subsidiaries service mortgages for third parties. A company that services mortgages is usually responsible for obtaining insurance protecting the collateral supporting such mortgages and, thus, the sale of insurance is directly related to the provision of a financial

service. Accordingly, the Board finds that the sale of insurance under such circumstances is within § 225.4(a)(9)(ii)(b).

Under No. 4 above, Applicant seeks to sell property and liability insurance which protects the value of assets being leased by Applicant or its subsidiaries. Property insurance protects the interest of Applicant in the assets being leased and, moreover, where liability insurance is sold as part of a package with property insurance, the former also is directly related to the provision of a financial service. Accordingly, the Board concludes that such insurance comes within § 225.4(a)(9)(ii)(b) of the Insurance Regulation since it is directly related to the provision of a financial service by a bank or bank-related firm.

Applicant has applied under 3(b) and 5(b) above for permission to sell business interruption insurance and loss of rent insurance. However, little or no evidence was presented orally, or otherwise, concerning these types of insurance. Accordingly, there is insufficient evidence in this record upon which the Board may determine whether the sale of such insurance is closely related to banking or managing or controlling banks.

Applicant seeks under No. (7) above, to sell credit life, credit accident and health, and mortgage redemption insurance where the Applicant or one of its subsidiaries is the named beneficiary. The Board has previously determined that the sale of these forms of insurance is within § 225.4(a)(9)(ii)(a) of the Insurance Regulation [4] and reaffirms that determination herein.

Finally, under No. (8), Applicant seeks to sell insurance that is otherwise sold as a matter of conveni-

[4] See Board Order relating to Worcester Bancorp, Inc., (1974 *F.R. Bulletin* 393) and the Board's Order relating to the application of the Alabama Financial Group, Inc. (39 *F.R. Bulletin* 25548).

ence to the purchaser. The premium income from sales in this category would not constitute a significant portion of the aggregate premium income from insurance sold in connection with the extension of credit or the provision of other financial services. Convenience sales are expressly permitted by the Board under § 225.4(a)(9)(ii)(c) of the Insurance Regulation. However, the Board does not regard this provision as permitting the entrance by any of Applicant's subsidiaries into the general insurance agency business.

In determining whether a particular activity is a proper incident to banking or managing or controlling banks, the 1970 Amendments to the Act require the Board to "consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices." The Board, in adopting the Insurance Regulation, found that the performance by bank holding companies of those activities authorized by such Regulation satisfied, in general, this public benefits test. Additionally, in considering this application the Board has specifically determined whether performance of insurance activities by this Applicant satisfies the public benefits test.

It is reasonable to anticipate that approval of the subject application will result in a greater convenience to the public. There is evidence in the record that the ability of a borrower to purchase insurance at the same location where he obtains credit is likely to result in savings in time as well as avoiding duplication of information common to both credit and insurance transactions. Although initially Applicant intends to have only one licensed agent at one of the branches of its bank-

ing subsidiary, borrowers from other branches and from Applicant's nonbanking subsidiaries can telephone the licensed agent and should be able to complete the insurance transaction at the time the credit is extended. This convenience may well be more apparent in regard to the sale of personal insurance than in the sale of commercial insurance; however, it appears that there is a commonality of information between existing commercial credit and commercial insurance so that convenience factors should be present in this context also. On the basis of this evidence, the Board concludes that consummation of this transaction would provide a greater convenience to the public and that this factor supports approval of the application.

It appears from the evidence of record that Applicant's sale of insurance would result in certain efficiencies. Almost all of the customers of the proposed agency will be referred to the agency by loan officers of Applicant. This should result in the reduction or, perhaps, even elimination of advertising and solicitation expenses. Moreover, there was testimony in the record that Applicant's banking subsidiary encountered problems in obtaining a verification of renewals of automobile insurance. This problem should be eliminated by having an agent affiliated with Applicant responsible for these renewals. There was also testimony that having the various loan officers of Applicant deal with one agent employed by Applicant would likely result in efficiencies through the establishment of a common pattern of operations. The Board concludes that such efficiencies taken in the aggregate constitute a public benefit and that this factor weighs in support of approval of the application.

It is reasonable to anticipate that Applicant's entry into the sale of certain insurance policies will result in increased competition among insurance agencies in Georgia. While this increased competition may not result in

more than a minimum amount of price competition, it is likely to produce increased competition on the basis of service to customers. For example, the ability to combine credit and insurance in one transaction at one location could be a means by which Applicant would be able to offer effective competition in the sale of these forms of insurance. Additionally, the availability of the financial expertise of Applicant should insure the borrower that he has obtained the proper package of insurance required by the lender. This would bring competitive pressure to bear on other insurance agencies to improve their services. Based on these and other facts and records, the Board concludes that consummation of the subject application would provide public benefits through increased competition.

One of the possible adverse effects which Congress directed the Board to consider in determining whether a particular activity is a proper incident to banking is the danger of undue concentration of resources. There is no credible evidence in this record establishing that consummation of this transaction would result in an undue concentration of resources. Applicant projects that during the first year of operation after approval of this application the insurance agency division of Tharpe and Brooks, Inc. will generate about $1.5 million in premium income. Even assuming that Applicant's premium income would be substantially greater than this projection, premium income of such volume cannot be viewed as an undue concentration of resources of the magnitude which Congress visualized in adopting § 4(c)(8) of the 1970 Amendments. Nor, considering the numerous banking alternatives available in Atlanta, is it likely that Applicant will be able to dominate the insurance agency business through the sale of such insurance by its banking subsidiary. Accordingly, the Board concludes that Applicant does not possess sufficient market power to deny its entry into the insurance agency field.

Another possible adverse effect which the Congress directed to the Board to consider in any § 4(c)(8) application is the danger of decreased or unfair competition. Intervenors vigorously contested this application on such grounds. Their argument was that permitting Applicant to sell insurance would lead to coerced or voluntary tying [5] of insurance to extensions of credit by Applicant. The incidence of tying would allegedly be particularly widespread in times of "tight money." It appears that the Law Judge was concerned with such a possibility and accordingly recommended that Applicant not be permitted to sell several types of insurance in the Atlanta area where Applicant's banking subsidiary held approximately 24.5 per cent of the total deposits in commercial banks.

However, the evidence of record contains no specific instances of a tying arrangement resulting from either coerced or "voluntary" tying. In fact, a witness for the intervenors admitted that he knew of no attempt by Applicant to coerce borrowers to purchase insurance. On the other hand, there was testimony by Applicant's witnesses that insurance was not discussed with borrowers until after the loan transaction was closed. This would appear to alleviate any potential danger of voluntary tying. Moreover, it is clear that coerced tying is forbidden by § 106 of the Bank Holding Company Act and, under certain conditions, by provisions of the antitrust laws. For these reasons, in addition to Applicant's commitment not to coerce borrowers to buy insurance, the Board concludes that the dangers of coerced tying are not substantial and should not bar Applicants sale of insurance in the Atlanta area.

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[5] Voluntary tying results not from any coercion placed on the borrower by the lender but rather from the borrower's presumed desire to enhance the probability of obtaining a loan.

Further evidence that would indicate that the amount of voluntary tying that would arise from the ability of Applicant to sell insurance would not be substantial include testimony that Applicant, through its subsidiary Tharpe and Brooks, Inc., had been able to sell insurance to only approximately 13.5 per cent of the mortgage borrowers of this firm. It appears that an even lower percentage of automobile loan borrowers from Applicant also purchased automobile insurance from the Applicant's insurance agency. Additionally, as noted above, there are numerous alternative commercial banks in Atlanta to which a borrower may turn. There are also many nonbank lenders which compete in the Atlanta area. Borrowers can obtain automobile loans from sales finance companies, personal loans from consumer finance companies and credit unions, and mortgage loans from savings and loan associations and mortgage bankers. Considering these nonbank sources of credit together with the banking alternatives in Atlanta, the Board concludes that the sale of certain forms of insurance by Applicant will not create a possible danger of voluntary tying by borrowers of their insurance needs to their loans. Accordingly, the Board does not believe that Applicant should be foreclosed from selling insurance in Atlanta or that the public should be denied the greater conveniences, efficiencies, and increased competition that are likely to result from approval of the application. It is the Board's judgment that consummation of the proposal would not result in decreased or unfair competition.

The Law Judge recommended in his decision that "appropriate statements be included in all insurance application forms furnished by affiliates of the Applicant, in bold type above the borrower's signature, to the effect that the customer understands the placement of such insurance is not offered as a condition to the grant of credit, nor is an inducement therefor . . ." The Board

notes that similar statements are likely to be included in all Truth in Lending disclosures made pursuant to the Board's Regulation Z with respect to credit life, accident and health, or loss of income insurance and it finds that the evidence in this record is not sufficient to otherwise require such language.

The Law Judge also recommended as a condition of approval that language be added to insurance application forms indicating that "similar insurance, not necessarily naming the lending institution as beneficiary, may be obtained from independent agents or in lieu thereof, that existing insurance owned by the debtor may be assigned to the bank" (page 20). The Board has not required this specific condition before; it notes that a similar statement will most likely be involved in appropriate Truth in Lending disclosures under the Board's Regulation Z with regard to casualty and liability insurance, and it believes that the evidence in this record is insufficient to demonstrate a public need for such a requirement beyond that reflected in Regulation Z.

Finally, in passing on an application under § 4(c)(8), the Board is required to consider whether conflicts of interests or unsound banking practices might arise from Applicant's entry into the insurance agency business. There was no evidence in this record to indicate such possibilities and the Board concludes that consummation of the transaction would not result in either conflicts of interests or unsound banking practices.

Subsequent to the Law Judge's decision in this case, legislation was passed by the Georgia legislature which arguably bore upon this application. Copies of such legislation, § 56-322 of the Georgia Code, were provided the parties and they were given the opportunity to comment. The parties' comments have been received, and the Board has considered such legislation and the parties' comments thereto.

In general, § 56-322 would restrict the types of insurance that a bank holding company could sell in Georgia. Applicant and CPCO have argued that such legislation by its terms does not apply to Applicant. The Board agrees with this contention since 1(d) of § 56-322 provides that any officer or employee of a bank holding company licensed to sell insurance in Georgia on January 1, 1974, and operating continuously since that date is not subject to the restrictive terms provided for in 1(a) of § 56-322.[6] The record establishes that Applicant acquired Tharpe and Brooks, Inc. in 1970 and has operated the insurance agency division of the company since then until the present time with appropriately licensed agents. Thus, Applicant appears to come within the exemptive provisions of 1(d) of § 56-322 and the Board concludes that Georgia law does not clearly prohibit the insurance activities in which Applicant seeks to engage.

The Board notes that NAIA has objected to the exclusion by the Law Judge of certain testimony of Mr. Harrison Houghton, a witness for NAIA. The Board, after examining the record, concludes that the Law Judge correctly exercised his discretion in refusing to admit this testimony since it was cumulative to other testimony in the record and, moreover, irrelevant to many of the issues involved in this application.

NAIA filed a motion to exclude Board personnel who were involved in this hearing from participating "in the

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[6] Section 1(d) of § 56-322 reads as follows:

(d) Nothing contained within this Section shall apply to any lending institution, bank holding company, nor to any organization which was a subsidiary or affiliate of either of the foregoing on January 1, 1974, nor to any officer or employee of the foregoing, if on January 1, 1974, such lending institution, bank holding company, subsidiary or affiliate, officer or employee was licensed to operate and was conducting business in conformity with all Federal and State laws applicable thereto, and all Federal and State rules and regulations applicable thereto and who have since January 1, 1974, been in continuous operation.

making of the Board's decision" on this application. Since such personnel of the Board did not participate in the decisional process, the issue raised by the motion is moot.

Based on the foregoing and other considerations reflected in the record, the Board has determined that the balance of the public interest factors the Board is required to consider under § 4(c)(8) is favorable. Accordingly, the application is hereby approved subject to the exceptions noted above. This determination is further subject to conditions set forth in § 225.4(c) of Regulation Y and to the Board's authority to require such modification or termination in the activities of the holding company or any subsidiaries as the Board finds necessary to ensure compliance with the provisions and purposes of the Act and the Board's regulations and orders issued thereunder or to prevent evasion thereof. The transaction here approved shall be made not later than three months after the effective date of this Order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Atlanta pursuant to delegated authority.

By Order of the Board of Governors,[1] effective September 5, 1974.

/s/ Theodore E. Allison
THEODORE E. ALLISON
Secretary of the Board

[SEAL]

[1] Voting for this action: Chairman Burns and Governors Mitchell, Sheehan, Holland, and Wallich. Absent and not voting: Governor Bucher.

APPENDIX G

Recommended Decision of the Administrative Law Judge

FRB Docket IA-10

(Southern Bancorporation)

[Served Feb. 7, 1974, Federal Reserve System]

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

DOCKET NO. IA-10

THE ALABAMA FINANCIAL GROUP, INC.
Birmingham, Alabama

Application to engage in
certain insurance agency activities

RECOMMENDED DECISION OF
PAUL N. PFEIFFER,
ADMINISTRATIVE LAW JUDGE

Recommended:

Application of Alabama Financial Group, Inc., a bank holding company, to engage *de novo* through a non-banking subsidiary in credit-related insurance agency sales granted with respect to proprietary and employee insurance and for credit life, health and accident and mortgage redemption insurance but denied as to other forms of insurance in Birmingham, Dothan and Marion County, Alabama where applicant's banking subsidiaries control more than 15% of area deposits. Application granted as to credit-related insurance agency sales except surety

bonding to customers of banking and non-banking affiliates located in Huntsville, Mobile and other areas where less than 15% of area deposits are controlled. Furnishing of anti-coercion statements for prior execution by loan/insurance customers required.

Served upon:

Macbeth Wagnon, Jr., Esq., Bradley, Arant, Rose & White, 1500 Brown-Marx Building, Birmingham, Alabama 35203, attorney for The Alabama Financial Group, Inc.

Herbert E. Marks, Esq., and *Thomas E. Wilson, Esq.*, Wilkinson, Cragun & Barker, 1735 New York Ave., N.W., Washington, D.C. 20006, *John F. Neville, Esq.*, General Counsel of NAIA, 85 John Street, New York, New York 10038, and *Bibb Allen, Esq.*, London, Yancey, Clark and Allen, First National Southern Building, Birmingham, Alabama, representing National Association of Insurance Agents, the Alabama Association of Insurance Agents, and the Independent Insurance Agents of Birmingham.

James I. Keenan, Jr., Esq., P.O. Box 1138, Baltimore, Maryland 21203, attorney for United States Fidelity and Guaranty Insurance Company.

Lawrence F. Noble, Esq., Metzger, Noble, Schwarz & Kempler, One Farragut Square South, Washington, D.C. 20006, attorney for Committee to Preserve Consumer Options.

Raymond Kit Carson, Esq., and *Michael H. Zimring, Esq.*, Board Counsel, Federal Reserve System, 20th & Constitution Ave., N.W., Washington, D.C. 20551.

Exceptions, if any, to this Recommended Decision may be filed with the Secretary, Federal Reserve System and served upon all counsel of record within fifteen (15) days from the service date above.

1

PRELIMINARY STATEMENT

This proceeding involves an application filed by The Alabama Financial Group, Inc. (TAFG), a holding company owning seven banking subsidiaries located in Birmingham, Dothan, Mobile, Huntsville, Gwin, Anniston, and Bay Minette, Alabama to enter the credit related insurance agency business through a subsidiary to be organized.

The proceeding is a companion to consolidated Dockets IA-3, 6, 7, 12 and 13 involving applications by certain bank holding companies to enter the insurance agency business through subsidiaries located principally in Florida and Docket IA-8, a similar application relating to the state of Georgia. The issues are substantially the same and certain of the testimony introduced in the previous records has been incorporated herein. The Recommended Decision in the Florida case was issued on November 9, 1973 and in the Georgia case on January 14, 1974.

The application is brought under Section 4(c)(8) of the 1970 Amendments to the Bank Holding Company Act, (12 USC par. 1843(c)(8) as well as pursuant to Regulation Y, Section 225.4(a)(9) [12 CFR 225.4(a)(9)]. The application is opposed by the National Association of Insurance Agents (NAIA), the Alabama Association of Insurance Agents (GAIA), the Independent Insurance Agents of Birmingham and U.S. Fidelity and Guarantee Company (USF&G). An organization of bank holding companies known as the Committee for the Protection of Consumer Options (CPCO) intervened on behalf of Applicant. Board Counsel entered a special appearance but took no position on the merits of the application.

After due notice the application came on for public hearing in Atlanta, Georgia on June 25, and was con-

cluded on June 26, 1973. After an opportunity was afforded for the filing of opening and reply briefs [1] the case was submitted for recommended decision on January 4, 1974.

II

THE APPLICATION

TAFG was organized in 1968. It has active banking subsidiaries located in Birmingham, Dothan, Huntsville, Mobile and Guin, Ala.[2] The Birmingham subsidiary (Birmingham Trust National Bank) has 22 banking offices in Jefferson County; First National Bank of Dothan has 8 offices in Houston County; The Peoples National Bank of Huntsville has 3 offices in Madison County; The Commercial Guaranty Bank of Mobile has 4 offices in Mobile County, The Marion County Banking Company has 2 offices in Marion County making a total of 39 banking offices in 5 Alabama counties. TAFG also has two non-banking subsidiaries: The AFG Data Services, Inc. and the Alabama Financial Leasing, Inc.

Birmingham Trust is the second largest bank in Birmingham controlling 22.8% of its deposits. First National of Dothan is the largest bank controlling 46.7% of that city's deposits. Peoples National of Huntsville controls 8.4% of the deposits of that area. TAFG is the leader in Marion County with 45.5% of its deposits while Commercial Guaranty of Mobile has 4.2% of the deposits. As of December 30, 1972 the four banking subsidiaries then operating had outstanding loans amounting to $342,734,736.

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[1] The National Association of Casualty and Surety Agents (NACSA) did not enter an appearance at the hearing but filed a brief in opposition to the application.

[2] The record does not contain detailed information on the two newly acquired subsidiaries at Anniston and Bay Minette, Ala.

The proposed insurance agency will be a wholly owned subsidiary of TAFG located at the main office in Birmingham. At the outset it will be staffed by an agency manager who will be a licensed agent and one clerical assistant. There will also be clerical and other personnel at each of the banking offices of TAFG's five banking subsidiaries.

At the hearing the insurance proposed by TAFG included:

1. All insurance for TAFG and subsidiaries.
2. Any insurance by a prudent lender to protect the value of assets financed by TAFG or subsidiary including the following:
   (a) real estate improvements: property coverage, loss of rents, liability, homeowners, bonds;
   (b) business equipment: property and liability;
   (c) assets being administered:[3] property coverage, liability, bonds;
   (d) assets being leased: property coverage, liability;
   (e) inventory being financed: property coverage, business interruption, liability;
   (f) other personal property being financed including autos, boats, mobile homes, campers, and appliances: fire, theft, other perils, comprehensive, collision, marine, liability, property floaters.
3. Any insurance on the life or health of a borrower, mortgage life and credit life, disability income.
4. Insurance that is otherwise sold as a matter of convenience such as accident and health, automobile, property, casualty, life.

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[3] Subsequently eliminated.

5. A full line of general insurance at offices located in communities having less than five thousand population.

TAFG expects to generate approximately $200,000 in annual premiums from the requirements of the holding company and its subsidiaries and approximately $600,000 in annual premiums from its customers. Applicant will represent insurance companies selected as offering the best possible rates, coverages and services and will not unduly influence any loan customer to obtain insurance as part of a package.

TAFG argues that one stop insurance/financial services would represent an additional function of benefit to its customers and that there would be special incentives to offer insurance at lower rates which cannot possibly be economically offered by independent agents. For example, TAFG has observed that independent agents are frequently reluctant to write credit life and disability insurance on existing loans or to write property damage and liability insurance on automobiles older than three years. In addition, the need for carrying "holder's interests only" insurance, covering the situation when borrowers fail to renew insurance coverage required by the financing contract, will be eliminated.

TAFG expects to achieve operating economies through the use of its data processing equipment by TAFG Services, Inc., a TAFG subsidiary. Information obtained during the course of credit evaluation will not be duplicated; overhead will be saved by using existing office facilities and supplies; borrowers will avoid losses through the unwarranted assumption that the lender has provided for his insurance needs; increasing competition among banks may be expected to result; and finally TAFG Insurance Agency will arrange for financing insurance premiums.

III

THE OPPOSITION

NAIA opposes the application arguing first that the applicant is wholly inexperienced in the insurance agency business, neither of its witnesses having had any previous activity therein. The convenience of one-stop shopping is considered generally overrated since TAFG will only have one centralized insurance office and communication between the banking offices and the agency would require telephones or the customer would have to go to the agency for personal consultation. Surety bonding is alleged to represent a conflict of interest since the interest of the lender and that of the insurer are diametrically opposed.

NAIA also claims that the scope of the insurance to be offered has been greatly enlarged in the briefs from that proposed at the hearing. NAIA criticizes the predominant use of unlicensed personnel to solicit and write insurance. The Agents point out that under Alabama law no person may act or hold themselves as an insurance agent or solicitor without actually being licensed as such. On this basis only the licensed agent at the centralized location could take an application for insurance. Also Applicant apparently does not intend to use the less expensive direct billing procedures but instead will utilize its own data processing subsidiary which does not specialize in insurance operations. In addition the Agents point out that under Alabama law state banking institutions cannot sell insurance and therefore the granting of the application in this case would give Applicant an undue advantage over the state banks. The Agents also charge that there could be a conflict of interest by reason of the fact that the bank employee will consider the interests of the bank as well as the interest of the insured

and where they conflict, the employee will be unable to give objective advice to the insured.

NALU states its disagreement with the 15% standard established in the Recommended Decision in the Florida cases under which a holding company would be barred from entering the insurance agency business in those areas where its banking subsidiaries control more than 15% of the deposits. NALU thinks the percentage is too high; that offices in the permissible area may be used by customers in areas where the holding company would be barred as a funnel for their insurance needs in order to avoid the prohibition. NALU suggests that the standard should be reduced to the level of 5% of deposits, so as to bar any bank-affiliated insurance agency in any area where the bank controls more than this percentage.

IV

LEGISLATIVE DIRECTION

The Congressionally prescribed criteria for consideration of the application are set forth in Section 4(c)(8) of the 1970 Amendments to the Act. These prohibit the acquisition by a bank holding company of ownership or control of any voting shares of any company which is not a bank except:

> "(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as

> greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern; . . ."

A fair summary of the legislative history as partially abstracted in the companion Recommended Decisions[4] indicates that the Congress clearly had credit-related insurance agency sales in mind as an enterprise closely related to banking, subject however to surviving the gamut of a net public benefits test; that a suggestion of Chairman Burns that the "closely related" standard be construed in the broad sense of authorizing entrance by bank-related insurance agency subsidiaries into markets other than those penetrated by the banking affiliates rather than being tied geographically to the banks' areas was endorsed by both Houses; that a preference was expressed in favor of *de novo* entry rather than entry by acquisition of an existing concern; and that the application of the legislative standards in a flexible manner should be entrusted to the Board whose expertise in evaluating financial evidence developed through an adversary public hearing can best determine whether the public benefits *reasonably expected* to be obtained through granting an application under Section 4(c)(8) outweigh the *possible* adverse effects.

To implement the insurance agency aspects of the 1970 Amendments, the Board *inter alia* promulgated Sec. 225.4 (a)(9) of Regulation Y therein describing the following

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[4] Recommended Decision Docket Nos. IA 3, 6, 7, 12 & 13 issued November 9, 1973, pp. 15-22; Docket No. IA-8, pp. 9-16, issued January 14, 1974.

insurance activities as "so closely related to banking or managing or controlling banks as to be a proper incident thereto:"

> "(9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:
>
> (i) Any insurance for the holding company and its subsidiaries;
>
> (ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii) (c) does not constitute a significant portion of the aggregate insurance sold pursuant to this subdivision (ii);
>
> (iii) Any insurance sold in a community that (a) has a population not exceeding 5,000, or (b) the holding company demonstrates has inadequate insurance agency facilities."

The above regulation was attacked on judicial review by the Agents who charged that the Board acted improperly in adopting the regulation without notice and hearing, and without articulating adequate reasons based upon substantial record evidence. On January 9, 1974 the Court of Appeals, in dismissing the Agents' appeal as premature, affirmed the Board's action as an interpretative rule not requiring prior notice and hearing and pointed out that the Agents can oppose particular ap-

plications of the 1972 rules in proceedings such as the one at bar subject to later court review.[5]

V

PRELIMINARY FINDINGS AND CONCLUSIONS

The evidence and argument in this case are substantially similar to that of the companion proceedings upon which recommendations have already been issued. Consequently, the Recommended Decision herein will follow closely the outlines of those previously considered.

The legislative history of the 1970 Amendments to the Bank Holding Company Act included references to sales of credit related insurance as examples of activities closely related to banking.[6]

In Section 4(a)(9) of Regulation Y the Board broadly construed the "closely related" umbrella to include insurance sales directly related to extensions of credit or other financial services by a bank or bank-related firm and also to include a limited volume of other insurance sold as a matter of convenience to customers of the holding company and its affiliates. NAIA's challenge to the validity of this regulation was rejected on court review on the reasoning that the particular application of this interpretative rule could be litigated herein among other proceedings.

NAIA argues that the business of selling insurance covering the borrower's interest as distinguished from the bank's interest in protecting the security for its loan is not directly related to banking or so closely related as to

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[5] *NAIA et al.* v. *Board of Governors of the Federal Reserve System* D.C. Circuit, Docket No. 72-1938, Slip opinion January 9, 1974.

[6] Statements of former FRB Chairmen Martin and Burns, Cong. Rec. S-20651, December 18, 1970.

be a proper incident thereto. The argument lacks merit for the bank is primarily interested in the personal and financial security of the borrower and only secondarily interested in the integrity of the loan collateral. In other words, normally banks are primarily interested in repayment of their loan. Sale of collateral such as a car, a house, or commercial asset is clearly less desirable. Therefore, the insurance of any property or personal interest of a borrower which, if destroyed, could affect the repayment of the loan, is considered to be so closely related to banking (making a loan to the borrower) as to be a proper incident thereto.

No distinction was drawn between insurance covering the collateral for a loan and that protecting the financial security of the borrower in the final Congressional discussions of the "closely related" test. Therefore it is concluded that the full range of credit-related insurance sales was intended to be included within the "closely related" umbrella subject, however, to findings that the public benefits "reasonably . . . expected" to be derived from approval of a specific application in terms of greater convenience, increased competition and gains in efficiency, outweigh the "possible" adverse effects of undue concentration of resources, decreased or unfair competition, conflicts of interests [7] or unsound banking practices.

There does not appear to be a reasonable expectation of a substantial increased convenience to the public resulting from the proposed bank affiliated insurance activities. The use of only one licensed agent is questionable in view of the expected volume of operations. The centralized agency location would make personal service relatively inconvenient. The insurance customer would be better served by going to his nearby independent agent

[7] Conflicts involving trusteed assets and surety bonding are discussed infra p. 18 fn. 9.

for consultation rather than to a bank office some distance from the insurance agency subsidiary.[8]

The failure of the proposed agency to utilize the direct billing method negates a reasonable expectation that operating economies may be attained which would be passed on to customers. Although the record contains suggestions that the holding company would be able to bring pressure upon insurance underwriters to lower their rates for the benefit of its customers, there is no hard evidence that discussions have been had with any insurance underwriters along these lines, or that a firm proposal for lower premiums exists.

Since the Applicant is the second largest bank in Birmingham controlling 22.8% of its deposits, the largest bank in Dothan with 46.7% of deposits, the leader in Marion County with 45.5% of the deposits, it is evident that in those areas Applicant would have a dominant position in terms of captive clientele which could be influenced to divert from local existing independent insurance agencies. While coercive tying of insurance sales to lending is illegal under Section 106 of the Act, "voluntary" tying through subtle influencing particularly in times of tight money is a distinct possibility despite protestations of TAFG witnesses to the contrary.

However, in Huntsville where the TAFG subsidiary controls only 8.4% of deposits, and Mobile (4.2% deposit control), the effect of voluntary tying would be minimal if the application were granted. In those areas loan customers who prefer to buy insurance through a bank affiliate may do so without substantially jeopardizing competing independent agents. The number of Birmingham, Dothan, and Marion County customers who would seek to circumvent this ruling by dealing through Huntsville, Mobile et al. subsidiaries would not likely

[8] The proposal to finance premiums at bank interest rates can hardly be described as a convenience when compared with the low service charges levied by the large direct writers.

be large and could be controlled through reporting requirements.

The business of surety bonding by a subsidiary of a bank holding company represents a conflict of interest in that bonding is frequently offered as a condition precedent to the consummation of a loan. Put another way the sale of surety bonds carries with it the prerequisite that the purchaser secure a line of credit from a lender in order to establish his economic solvency in the eyes of the underwriter. Since the insurance agency affiliate would stand to gain from the writing of the surety bond, the banking affiliate might be tempted to extend the necessary letter of credit even though sound banking practice would not so dictate. Conversely a letter of credit may be withheld unless the surety bond is placed through the affiliated agency.[9]

The Agents charge that Applicant may in certain situations engage in a conflict of interest by considering the interest of the bank over that of an insurance customer has not been substantiated as a distinguishing feature. Any insurance agent may also be motivated by a desire to maximize his commission and to that extent may be unwilling to give objective advice to a customer in certain situations.

Under these circumstances a conflict of interest between surety bonding and lending is present and authority for a bank affiliated insurance agent to sell surety bonds should be withheld.

Applicant's comment[10] that independent agents are reluctant to write credit life and disability insurance

[9] A similar situation with respect to trusteed assets is now moot since TAFG has deleted this from its application.

[10] Applicant's charge that independent agents are also reluctant to write property damage and liability insurance on automobiles older than three years has not been substantiated by confirming evidence.

reflects the fact that the low premiums involved require a volume business in order to be successful. Credit life, health and accident and mortgage redemption insurance can be more economically processed on a group basis by a bank affiliated agency.

In summary, the application does not offer a reasonable expectation of substantial public benefits except possibly the addition of a well financed multi-office competitor in Birmingham, Dothan and Marion County. Approval in those areas would give Applicant an advantage over state banking institutions and would subject local independent insurance agencies to destructive competition through the possibility of voluntary tying (insurance with lending), particularly in periods of tight money. On the whole the reasonable expectation of public benefits appears to be outweighed by the possibility of the adverse effects indicated in these localities.

The proposition reduced to its simplest terms comes down to this: if a bank, large in its community, using predominantly depositors' funds as capital, is authorized to compete against mostly small insurance enterprises by soliciting its debtor-clientele, it is possible, even probable, that the Mom and Pop agency will be driven into merger or out of business entirely; and, to this extent, the American dream of a land of opportunity where every man and woman, with some skill and good luck, can become a proprietor or a partner, rather than merely a clerical employee or an insignificant stockholder, will fade further. This prospect, however, is not likely to materialize in those communities where the banking affiliate controls approximately 8% or 4% of local deposits.

Although an anti-coercion statement that prospective debtors sign at the time loans are negotiated may more likely protect a bank against prosecution for coercive practices than protect the borrower against subtle influ-

ences, nevertheless there is a public benefit to be served in at least reminding a customer that he can go elsewhere to procure insurance having no relation to the credit process. Therefore, it will be recommended that appropriate statements be included in all insurance application forms furnished by affiliates of the Applicant in bold type above the borrower's signature to the effect that the customer understands that the placement of such insurance is not offered as a condition to the grant of credit, nor as an inducement therefor; and, in addition, that similar insurance not necessarily naming the lending institution as beneficiary may be obtained from independent agents or, in lieu thereof, that existing insurance owned by the debtor may be assigned to the bank.

VI

RECOMMENDED DECISION

(1) That the application of the Alabama Financial Group be granted with respect to proprietary and employee insurance and for credit life, health and accident and mortgage redemption insurance but denied as to all other forms of insurance in Birmingham, Dothan and Marion County, Alabama.

(2) That the application be granted as to credit-related insurance agency sales except surety bonding to customers of banking and non-banking affiliates located in Huntsville, Mobile and any other area in which a banking subsidiary may be acquired in which said subsidiary controls less than 15% of local deposits.

(3) That, in those respects in which the application is granted, the authorization be subject to appropriate anti-coercion statements to be furnished for execu-

tion by loan/insurance customers as part of their applications.

/s/ Paul N. Pfeiffer
PAUL N. PFEIFFER
Administrative Law Judge

DECIDED: February 7, 1974

APPENDIX H

Recommended Decision of the Administrative Law Judge

FRB Docket IA-8

(First National Holding Corp.)

[Served Jan. 14, 1974, Federal Reserve System]

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

DOCKET NO. IA-8

FIRST NATIONAL HOLDING CORPORATION
Atlanta, Georgia
Application to engage in
certain insurance agency activities

RECOMMENDED DECISION OF
PAUL N. PFEIFFER,
ADMINISTRATIVE LAW JUDGE

Recommended:

That application by First National Holding Corporation to enter the credit-related insurance agency business through a non-banking affiliate be approved in those areas outside Atlanta, Ga. where applicant's affiliated operations have not attained a major position, subject to the

limitations of Regulation Y, Sec. 225.4(a)(9). Atlanta operations restricted to proprietary and employee insurance and credit life, health, accident and mortgage redemption insurance sales. Appropriate anti-coercion statements required.

Served upon:

J. W. Gibson, Esq., McChesney Jeffries, Esq., Howard O. Hunter, Esq., and *Kent E. Mast, Esq.*, Hansell, Post, Brandon & Dorsey, 3300 First National Bank Tower, Atlanta, Georgia 30303, attorneys for First National Holding Corporation.

Herbert E. Marks, Esq., Thomas E. Wilson, Esq., and *John F. Neville, Esq.*, Wilkinson, Cragun & Barker, 1735 New York Ave., N.W., Washington, D.C. 20006, attorneys for National Association of Insurance Agents, and *Robert R. Richardson, Esq.*, Hurt, Hill & Richardson, William Oliver Building, Atlanta, Georgia 30303, attorney for Georgia Assoc. of Insurance Agents.

James I. Keenan, Jr., Esq., P.O. Box 1138, Baltimore, Maryland 21203, attorney for United States Fidelity and Guaranty Insurance Company.

Lawrence F. Noble, Esq., Metzger, Noble, Schwarz & Kempler, One Farragut Square South, Washington, D.C. 20006, attorney for Committee to Preserve Consumer Options.

Raymond Kit Carson, Esq. and *Michael H. Zimring, Esq.*, Board Counsel, Federal Reserve System, 20th & Constitution Ave., N.W., Washington, D.C. 20551.

Exceptions, if any, to this Recommended Decision may be filed with the Secretary, Federal Reserve System and served upon all counsel of record within fifteen (15) days from the service date above.

I

PRELIMINARY STATEMENT

This proceeding involves an application filed by First National Holding Corporation (Applicant), a single bank holding company whose subsidaries operate in Georgia, Florida, South Carolina, Mississippi and Alabama, to enter the credit-related insurance agency business through First South Insurance Agency (Agency), a division of one of Applicant's mortgage banking subsidiaries, Tharpe and Brooks, Inc. (T & B) located in Atlanta,[1] Georgia. Applicant's only banking affiliate, First National Bank of Atlanta, (Bank), operates solely in the Atlanta area.

The proceeding is a companion to consolidated Dockets IA-3, 6, 7, 12 and 13 involving applications by certain bank holding companies to enter the insurance agency business through subsidiaries located principally in Florida. The issues are substantially the same and certain of the testimony introduced in the Florida case has been incorporated in the instant record. The Recommended Decision in the Florida case was issued on November 9, 1973.

The application is brought under Section 4(c)(8) of the 1970 Amendments to the Bank Holding Company Act, (12 USC par. 1843(c)(8) as well as pursuant to Regulation Y, Section 225.4(a)(9) [12 CFR 225.4(a)(9)]. The application is opposed by the National Association of Insurance Agents (NAIA), the Georgia Association of Independent Insurance Agents (GAIA), and U.S. Fidelity and Guarantee Company (USF&G). An organization of bank holding companies known as the Committee for the Protection of Consumer Options (CPCO) intervened on behalf of Applicant. Board Coun-

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[1] Agency also has offices in Albany, Athens, Augusta, Cobb County, Columbus, Decatur, Macon, and Savannah, Ga.

sel entered a special appearance but took no position on the merits of the application.

After due notice the application came on for public hearing in Atlanta, Georgia on June 27th, and was concluded on June 29, 1973. After an opportunity was afforded for the filing of opening and reply briefs the case was submitted for recommended decision on October 29, 1973.

II

THE APPLICATION

Holding Company was organized in 1969. Its sole banking subsidiary, First National Bank of Atlanta (the Bank), conducts a general commercial banking and trust business in Fulton and DeKalb Counties, Ga., at 41 offices in the Atlanta area with deposits of $1,030,000,000 representing 24.3% of the deposits in the SMSA. Total loans at the end of 1972 were $951,000,000 and operating income $98,000,000. Bank is the second largest banking institution in Atlanta.

Holding Company owns 22 subsidaries[2] operating in various parts of Georgia, South Carolina, Florida, Mississippi, Alabama and Louisiana providing financial services of various kinds including data processing, bank records storage, leasing of personal property and equipment, brokerage and mortgage banking, factoring and commercial and real estate financing.

[2] Bank Records Storage Company, Dixie Finance Company, Inc., Dynabank, Fairlane Finance Company, First Atlanta International, First Atlanta Tri-South, First Bank Building Corp., First National Bank of Atlanta, First National Building Corp., First National—Heller Factors, First South Data Processing, First South Financial Corp., First South Homeowners Co., Inc., First South Leasing Company, Kenesaw Finance Co., Gulf Finance Corp. of Mississippi, Lafayette, Inc., London Interstate Bank Ltd., Tri-South Management Associates, Woods-Tucker Leasing Co., and Tharpe and Brooks, Inc.

Among the subsidiaries acquired in 1970 is T & B, which has been in the mortgage banking business since 1947, originating FHA and VA single and multi-family loans for resale to permanent investors and also brokering development and construction loans for commercial projects and single and multi-family housing. As of May 31, 1973 T & B serviced property worth $420 million and in 1972 closed $152 million in loans. T & B is also a parent of a wholly owned subsidiary, First South Homeowners Co., Inc., engaged in second mortgage banking in Georgia, Florida, South Carolina and Alabama. Since 1970, T & B has acted as an agent for the sale of mortgage life and accident and health insurance to homeowners served by Holding Company and its subsidiaries. In anticipation of the grant of the current application (effective June 1, 1973) T & B sold all of its insurance agency activities to an independent agency, Tharpe and Associates, Inc.,[3] except those sought herein by its division, First South Insurance Agency.

Applicant seeks to obtain permission to sell the following types of insurance: (1) any insurance for Holding Company and its subsidiaries, (2) any insurance required by Bank or its subsidiaries to protect assets being financed such as autos, boats, and mobile homes, campers and appliances and including fire, theft and other perils, comprehensive, collision, marine liability and property floaters; (3) any insurance required by Bank to protect the value of inventory being financed by Holding Company or its subsidiaries such as property coverages, business interruption, and liability, (4) insurance to protect the value of assets being leased where Holding Company or its subsidiaries is the lessor such as property and liability, (5) insurance on real estate improvements including property coverage, loss of rents, liability, home-

[3] T & B and Tharpe and Associates, Inc. have numerous common officers, directors and stockholders.

owners and performance bonds, (6) insurance on business equipment being financed such as property and liability, (7) insurance on the life or health of a borrower or lessee of Holding Company or a subsidiary such as disability income, mortgage life, and credit life, (8) insurance that is otherwise sold as a matter of convenience to the purchaser such as accident and health, automobile, property, casualty and life.

The proposed insurance is intended to cover the interest of the lender, and also the borrower to the extent that the borrower requests, and will include in one policy liability as well as property coverage. With respect to life insurance, Applicant will seek to sell only the amount of insurance the lender will require.

The proposed insurance agency will be a centralized operation having offices at 615 Peachtree Street, Atlanta, in the same building as T & B and the second largest branch of Bank. This location is approximately two miles from Bank's main office. The staff will be composed of one licensed agent and five assistants presumably unlicensed. There will be a direct telephone line to each Bank office. It will have access to an IBM 360 computer system of a service bureau which does not specialize in insurance agency operations and will not use direct billing. Applicant will not have access to the credit and investigative files of any of the holding company subsidiaries including the bank. Insurance coverage for a prospective borrower will be arranged by a Bank loan officer or the prospective borrower calling the First South Insurance Agency. Presumably personal contact would have to take place at the Applicant's office. Applicant states that the borrower will not be told about Bank's requirement for insurance to protect collateral for its loan until after approval of the loan and he will be told that he is free to obtain insurance elsewhere.

The Citizens and Southern Holding Co., the largest banking organization in Atlanta with 65 offices and 28.5% of the deposits received authority from the Board in 1969 for a subsidiary to enter the credit related insurance agency business. The subsidiary's president testified during the Florida proceeding [4] that in 1972 in Atlanta SMSA insurance policies covering 11.1 percent of its parent's automobile loans and 6.8 percent of the homeowners loans were written by that agency. Similarly to the applicant herein C & S Insurance operates by tie-line telephone to the C & S Bank offices. In the case of homeowner's and automobile insurance, policies are usually mailed without other personal contact with the customer. The C & S witness testified that the rates offered are the same as through independent agencies, the principal benefit to the customer being convenience. Also, C & S Insurance expects to generate a higher penetration of its loan customers in the future.

III

LEGISLATIVE DIRECTION

The Congressionally prescribed criteria for consideration of the application are set forth in Section 4(c)(8) of the 1970 Amendments to the Act. These prohibit the acquisition by a bank holding company of ownership or control of any voting shares of any company which is not a bank except:

> "(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper

[4] Consolidated Docket Nos. IA-3, 6, 7, 12 and 13 Tr. 1629-45.

incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern; . . ."

Prior to 1970, Section 4(c)(8) permitted multi-bank holding companies to acquire shares of companies whose activities would be of a "financial, fiduciary, or insurance" nature and which the Board determined was "so closely related to the business of banking or of managing or controlling banks as to be a proper incident thereto." No regulation was imposed on single bank holding companies some of which promptly proceeded to acquire enterprises in related fields and in turn were acquired by large conglomerates.

In forwarding the proposed amendments to the Congress on March 24, 1969, President Nixon described the current situation as "disturbing" and representing an "erosion of the traditional separation of powers between the suppliers of money—the banks—and the users of money—commerce and industry." The President stated:

> "Left unchecked, the trend toward the combining of banking and business could lead to the formation of a relatively small number of power centers dominating the American economy. This must not be permitted to happen; it would be bad for banking, bad for business, and bad for borrowers and consumers."

He went on to conclude that:

> "Banking must not dominate commerce or be dominated by it." [5]

The principal effect of the 1970 amendments was to subject single bank holding companies to Board regulation. In addition a net public benefits test was imposed on non-bank acquisitions. This standard requires the Board to carefully weigh the degree of public benefits in terms of greater convenience, increased competition or gains in efficiency reasonably expected to be derived from the proposed entrance by a bank holding company into a closely related non-banking function against possible adverse effects such as undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices. Efforts to broaden the "closely related" test by changing the language to "functionally related" were defeated. On the other hand, a House proposed so-called "negative laundry list" of proscribed non-banking activities including the insurance agency business was deleted in the final version of the Amendments by request of Senate conferees.

Prior to 1970, the Board had interpreted the "closely related" test in the 1956 Act as requiring a "direct and significant connection" between the activities of the proposed subsidiary and those of the holding company affiliated banks. However, in a letter to Congressman Wright Patman, Chairman of the House Banking and Currency Committee, Board Chairman Burns stated that:

> ". . . we do not believe it is desirable to unduly restrict entry by non-bank subsidiaries into markets that are distinct from those served by the subsidiary banks of the holding company. This position may

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[5] Cong. Rec. S 20647, December 18, 1970.

lessen risks of tie-ins and is consistent with governmental policies to promote competition."

The Chairman then went on to propose the deletion of language from the existing statute "(the business of) banking or of managing or controlling banks" so as to read "banking or managing or controlling banks 'having in mind indicating that a non-bank subsidiary's activity should be related to banking (or managing or controlling banks) generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved.'" [6]

On the Senate side Senator Sparkman summarized his views as follows:

> "I am convinced that the bill finally agreed to is a good one and will meet this need for flexibility while at the same time preserve ample protection for independent small businessmen to insure that they will continue to flourish." [7]

Senator Sparkman continued as follows:

> ". . . varies only slightly in language and none in substance from the language suggested by Chairman Burns in his letter of November 23rd. . . . It frees the Board of the restrictive precedents established under the present Act and it provides that permissible activities may be related to the business of banking generally, rather than perpetuating the concept that such activities must be related to the specific business carried on by the subsidiary banks of the particular holding company involved. Furthermore, it defines 'a proper incident' to banking in very broad terms of various benefits to the public as opposed to possible

[6] Letter dated November 23, 1970, reprinted at 116 Cong. Rec. (daily ed.) H 41959, December 16, 1970.

[7] Cong. Rec. S 20638, December 18, 1970.

> adverse effects. . . . Your conferees are satisfied that the new language will provide the flexibility desired with proper safeguards for the public interest." [8]

Senator Goodell explained his understanding of the philosophy of the bill in the following language:

> "I believe the public interest or benefit should be the most important consideration in any case and that the underlying component of the public interest is the maintenance of competition in each local market and the prevention of concentration of economic power. . . .
>
> "In making its decision I feel certain the Fed. must strictly construe our requirement that the petitioning bank holding company show in detail that the acquisition will be in the public interest. Only in this way will they clearly know the consequences of the acquisition and only with the knowledge can a fair, studied judgment be made."

Senator Goodell continued:

> "The 'public interest' test is designed to avoid the concentration and misuse of economic power. First, it requires the bank holding company to demonstrate that the acquisition would provide benefits to the public such as greater convenience, increased competition or gains in efficiency. These benefits must outweigh possible adverse effects such as undue concentration of resources, decreased competition, conflicts of interests or unsound banking practices. The conferees make it perfectly clear that expansion into a particular activity should be authorized only where affirmative advantages to be public can be reasonably established. . . .

[8] Id. S 20640, December 18, 1970.

> "In general, the Fed. has been given the authority to approve acquisitions and make decisions based on the individual facts and circumstances of the applicant bank holding company and its impact in its market area. I believe this flexible, case by case approach is a preferred method of handling the complex questions relating to varied acquisitions." [9]

In discussing his understanding of the intention of the conferees, Senator Bennett cited testimony before the House and Senate Committees by former Board Chairman Martin as follows:

> "The Board believes that a bank holding company should be permitted to acquire a subsidiary subject to regulatory approval and supervision to engage in related activities without showing such a close connection between the business and that of a subsidiary bank. Permissible acquisitions might include for example . . . acting as insurance agent or broker or as an insurer in connection with extensions of credit by other subsidiaries of the holding company; . . ."

And Chairman Burns was quoted as follows:

> "By weighing the prospects of realizing such benefits against the risks of undesirable consequences, a judgment may be formed about the kinds of services bank holding company subsidiaries should be authorized to provide. In the Board's judgment authorized subsidiaries might well include . . . pertinent insurance functions in connection with services offered by other subsidiaries; . . ." [10]

In commenting upon both the House and Senate versions of the Bill, the Department of Justice stated as follows:

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[9] Cong. Rec. S 20644-5, December 18, 1970.

[10] Cong. Rec. S 20651, December 18, 1970.

> "The major feature of both versions is the empowering of the Federal Reserve Board to make full use of its economic competence and expertise in financial matters in authorizing the most effective use of the Nation's financial resources and talents." [11]

With specific reference to the question of "increased competition" and "gains in efficiency," a Department of Justice letter of November 17, 1970, had this to say:

> "Innovation in financial fields should be encouraged and it seems particularly desirable to permit bank holding companies to enter other financial markets where competition is weak or where real efficiencies will result."

The letter continued:

> "We believe that competitive aspects should play an important role in determining exactly which activities bank holding companies should be authorized to enter in related financial fields. . . . in particular, we consider differentiation between activities commenced *de novo* and activities commenced through acquisition of a going concern to be of prime importance inasmuch as the competitive aspects of a given bank holding company activity may be more substantially affected by the manner of entry than by the nature of the activity itself." [12]

With respect to non *de novo* acquisitions, the Conference Report stated:

> "Where a bank holding company enters a market through acquisition of a major going concern, it may not have the incentive to compete vigorously, thereby bringing the possible benefits into play, as it would

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[11] Cong. Rec. H 41957, December 16, 1970.

[12] Cong. Rec. H 41957, December 16, 1970.

immediately succeed to what it might consider its fair share of the market. On the other hand, where a bank holding company enters a new market *de novo*, or through acquisition of a small firm, as opposed to acquisition of a substantial competitor, its desire to succeed in its new endeavor is more likely to be competitive. This legislation specifically emphasizes the importance of the manner in which a bank holding company may enter new activities. Such considerations will be particularly important in the context of expansion by bank holding companies into new geographic markets." [13]

With respect to the "undue concentration of resources" criterion House Banking and Currency Committee Chairman Patman had this to say:

"One of the objects of the law is to keep the banks from acquiring insurance companies for the reasons gone into in the hearings before the Banking and Currency Committee on this bill. A half dozen banks could acquire a half dozen large insurance companies and have enough reserves to actually purchase many of the big profit making businesses in this country. That would create undue concentration of resources which is prohibited under Section 4(c)(8)." [14]

With respect to so-called "voluntary" tie-ins, the Conference Report stated:

"Section 106 of the bill, which has come to be known as the anti-tie-in section, will largely prevent coercive tie-ins and reciprocity. But the dangers of 'voluntary' tie-ins and reciprocity are basically structural and must be dealt with by the Board in

[13] H.R. Report No. 91-1747, pp. 17-18, December 15, 1970.

[14] Cong. Rec. H 41961, December 16, 1970.

determining the competitive effects of bank holding company expansion into fields closely related to banking when considering applications under Section 4(c)(8). These will be difficult questions, for assurances of good faith and the intention not to engage in tie-ins and reciprocity by the applicant bank holding companies will largely be irrelevant to the just as serious dangers of 'voluntary' tie-ins and reciprocity. The Board must, in any case, consider these problems in carrying out its responsibilities under the Act." [15]

A fair summary of the legislative history as partially abstracted above indicates that the Congress clearly had credit-related insurance agency sales in mind as an enterprise closely related to banking, subject however to surviving the gamut of a net public benefits test, that a suggestion of Chairman Burns that the "closely related" standard be construed in the broad sense of authorizing entrance by bank-related insurance agency subsidiaries into markets other than those penetrated by the banking affiliates rather than being tied geographically to the banks' areas was endorsed by both Houses, that a preference was expressed in favor of *de novo* entry rather than entry by acquisition of an existing concern, and that the application of the legislative standards in a flexible manner should be entrusted to the Board whose expertise in evaluating financial evidence developed through an adversary public hearing can best determine whether the public benefits reasonably expected to be obtained through granting an application under Section 4(c)(8) outweigh the possible adverse effects.

To implement the insurance agency aspects of the 1970 Amendments, the Board *inter alia* promulgated Sec. 225.4(a)(9) of Regulation Y therein describing the following insurance activities as "so closely related to banking or

[15] H.R. Report No. 91-1747, p. 18, December 15, 1970.

managing or controlling banks as to be a proper incident thereto:"

"(9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:

(i) Any insurance for the holding company and its subsidiaries;

(ii) Any insurance that (a) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (b) is directly related to the provision of other financial services by a bank or such a bank-related firm, or (c) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii)(c) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);

(iii) Any insurance sold in a community that (a) has a population not exceeding 5,000, or (b) the holding company demonstrates has inadequate insurance agency facilities."

IV

FINDINGS AND PRELIMINARY CONCLUSIONS

1. The business of selling credit-related insurance is so closely related to banking or managing or controlling banks as to be a proper incident thereto.

NAIA argues that the business of selling insurance covering the borrower's interest as distinguished from the bank's interest in protecting the security for its loan

is not directly related to banking or so closely related as to be a proper incident thereto. The argument lacks merit for the bank is primarily interested in the personal and financial security of the borrower and only secondarily interested in the integrity of the loan collateral. In other words, normally banks are primarily interested in repayment of their loan. Sale of collateral such as a car, a house, or commercial asset is clearly less desirable.

Moreover, the final debates in both Houses of Congress on the Amendments to the Bank Holding Company Act of 1970 included references to sales of credit-related insurance as examples of activities closely related to banking. Express reliance was placed on communications from Board Chairmen Martin and Burns to the same effect. Since no distinction was drawn between insurance covering the collateral for a loan and that protecting the financial security of the borrower in the final Congressional discussions of the "closely related" test, it is concluded that the full range of credit-related insurance sales was intended to be included within the "closely related" umbrella subject, however, to findings that the probable public benefits to be derived from approval of a specific application in terms of greater convenience, increased competition and gains in efficiency, outweigh the possible adverse effects of undue concentration of resources, decreased or unfair competition, conflicts of interests or unsound banking practices.

In Section 4(a)(9) of Regulation Y, *supra*, the Board broadly construed the "closely-related" umbrella to include insurance sales directly related to extensions of credit or other financial services by a bank or bank-related firm and also to a limited volume of other insurance sold as a matter of convenience to customers of the holding company and its affiliates.

This interpretation of the statute has been challenged by intervenors. However, such challenge is properly directed to the Board and/or reviewing courts. The Administrative Law Judge is not in a position to pass upon the soundness or legal validity of the Board's interpretation and no opinion on these subjects is expressed herein.

2. The proposed bank affiliated insurance activities can reasonably be expected to result in only minimum increased convenience to the public.

The argument that the public will be greatly convenienced by one-stop shopping for financial and insurance purposes at any of the Bank's offices in Atlanta is largely outweighed by the fact that the insurance activities will be concentrated at the Agency office on 615 Peachtree Street. This means that a borrower desiring to obtain insurance through Bank would be obliged to use, or have the bank branch loan officer utilize, the proposed direct telephone line to arrange the coverage. If he desires personal contact with an insurance agent he would have to visit the agency office. In complicated commercial insurance transactions it is likely that some personal consultation would be necessary.

The same customer could use his own business telephone or a public pay telephone for the same purpose or visit a nearby independent insurance agent. There are 105 such agents in the two-mile radius, center-city area of downtown Atlanta.

Agency would be staffed with one insurance agent and five assistants. Considering the expectable volume of business which could be generated by aggressive bank loan officers and applicant's other non-banking subsidiaries, the insurance operation, as proposed, does not portend to be a major convenience to Bank borrowers or customers of Holding Company's non-banking affiliates.

3. Since Agency will not use the direct billing method, it is doubtful that any gains in efficiency will be experienced which are not already being experienced by independent agencies.

Despite extensive prodding, Applicant is opposed to using the direct billing technique which large insurance underwriters have devised so as to bill customers directly and pass on to them the benefits of resulting lower agency commissions. Instead Applicant will utilize an outside data processing source.

The direct billing procedure is most prevalent in automobile and homeowners' insurance, particularly on renewal policies. Substantial savings have been experienced in agency expenses reflected in reduced customer premiums.

In summary, while Holding Company may experience some operating efficiency by adding insurance services to its banking and non-banking functions, there is no proof that the customer will benefit in terms of lower cost of insurance coverage. On the contrary Applicant's policy appears to deliberately avoid the most promising technique for insurance customer savings.

4. Approval of the application would probably result in additional units of insurance agency competition but there is no proof that such would result in savings to customers in the form of lower premiums.

There is no reliable or probative evidence in this proceeding establishing that approval of the application will result in savings to the insurance customers. There was testimony that pressure would be brought on underwriters to establish favorable rates but no hard evidence was presented of any prospective low premium schedule.

There would be substantial additional competition in the Atlanta insurance agency industry through the 41

bank branch outlets. However, with respect to the banking industry, it is noteworthy that state banks in Georgia do not possess authority to enter the insurance business. Therefore the grant by the Federal Government of this authority would give Applicant an undue advantage over Georgia state banking institutions.

NAIA has argued that Applicant must show a public "need" for its insurance services in order to obtain approval. Public convenience and necessity requirements have been carefully phrased by Congress in the Federal Aviation Act, the Motor Carrier Act, the Federal Communications Act *inter alia*. No such language surfaced in the Banking Act, as amended, despite some discussion in a House debate approximately one year before the crucial conference on the disagreeing votes of the two Houses (115 Cong. Rec. 33139—Nov. 5, 1969). Consequently, no firm Congressional intent to require a public need test can be found.

5. Entry by the applicant into the insurance agency business would result in an undue concentration of banking-insurance resources to the possible detriment of independent insurance agents in Atlanta.

Applicant controls 24.3% of the total deposits in the Atlanta SMSA. In addition, Citizens and Southern controls 28.5% of the same deposits. Together Applicant and C&S control over $2 billion of deposits in Atlanta. Assuming a loan ratio of 90%, it is apparent that their combined economic power would represent a formidable threat to the independent agencies by reason of the banks' advantage in terms of a very large built-in clientele of borrowers.

The C&S experienced penetration ratios of 11.1% and 6.8%, respectively, of borrower-automobile and homeowner insurance sales appears modest. There was testimony by an independent agent serving sub-standard risk

auto insurance customers that C&S was turning away high risk business. Nevertheless, aggressive salesmanship by both institutions could substantially impact the independent insurance agency business in Atlanta. Applicant alone forecast an agency earning $4,812,500 in annual premiums. If the application were granted and, as a result, the state of Georgia granted similar authority to its banks, the adverse impact upon the Atlanta insurance agents would possibly be substantial.

On the other hand, with respect to Augusta (Richmond County), Carroll County, Clarke County (Athens), Cobb County (Marietta, Smyrna), Muscogee County (Columbus), Decatur County, Macon SMSA, and Savannah SMSA where Applicant's non-banking subsidiaries operate, there is no evidence of any domination in those markets by Applicant's affiliates.

6. The record contains evidence of the possibility of tying insurance premiums into negotiations over interest charges in commercial loan transactions.

A witness for Applicant testified that in discussions with regard to the financing of a shopping center, the insurance income that would be involved if the application were granted could affect the lowering of interest rates on other charges and fees under the "package concept." In other words, First South would be "more receptive" to a borrower's last offer if insurance premiums were part of the total package.[16]

It is probable that consideration of the "package concept" would also carry over into the ordinary consumer personal loan transaction in the sense that in a period of tight money, Bank would be more willing to grant a loan to a depositor who would voluntarily also offer insurance coverage. Such a practice would not be sub-

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[16] Tr. 2331.

stantially unlike the common requirement of maintaining compensating non-interest bearing balances in the borrower's account as a condition for obtaining or renewing a personal or commercial loan.

In order to be effective the practice of tying lending with insurance coverage need not be coercive. Voluntary tying by customers in time of tight money or individual financial distress is possible.[17]

7. There is no evidence of potential conflicts of interest or unsound banking practices resulting from approval of the application.[18]

In summary, the application does not offer a reasonable expectation of substantial public benefits except possibly the addition of a well financed multi-office competitor in the Georgia insurance agency industry. As far as the insurance customer is concerned, he already has access to bank affiliated insurance services through Citizens and Southern Bank. First National Bank of Atlanta and C&S together would control more than 50% of all deposits in Atlanta. Assuming a 90% loan ratio, the clientele that could possibly be subtly influenced to divert from Atlanta independent agents is so large that many of the latter could be driven out of business or forced to merge into larger units resulting in decreased competition.

The large direct writers would probably be able to withstand the double-barrelled financial conglomerate competition in Atlanta because of their low cost—low

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[17] In Section 4(c)(8) of the Act, Congress did not require proof that adverse effects such as "tying" be established as "probable" consequences of bank affiliated insurance agency entry. The phrase "possible" adverse effects was employed denoting a lower standard of proof than "probable."

[18] The application does not expressly propose surety bonding which would result in a conflict of interest.

premium operations. But the independent commission agents would have difficulty surviving.

Since these are frequently small enterprises which can be entered with minimum capital and training, the public interest favors their protection and encouragement as reservoirs of economic opportunity for families, youths, veterans and women who aspire to become proprietors or partners rather than mere clerks in large organizations.

For the foregoing reasons, it is concluded that the reasonable expectation of public benefits to be derived from approval of this application is outweighed by the possibility of adverse effects upon the existing independent insurance agency community in the Atlanta area.

However, in those areas of Georgia where Applicant does not operate a banking subsidiary and where there is no evidence that its non-banking subsidiaries have attained a major position, there would appear to be no objection to its commencing credit-related insurance agency operations. Similarly with respect to Applicant's proprietary and employee insurance needs and credit life, health and accident, and mortgage redemption insurance to which there is no substantial opposition, the application should be granted.

Although an anti-coercion statement that prospective debtors sign at the time loans are negotiated may more likely protect a bank against prosecution for coercive practices than protect the borrower against subtle influences, nevertheless there is a public benefit to be served in at least reminding a customer that he can go elsewhere to procure insurance having no relation to the credit process. Therefore, it will be recommended that appropriate statements be included in all insurance application forms furnished by affiliates of the Applicant in bold type above the borrower's signature to the effect

that the customer understands that the placement of such insurance is not offered as a condition to the grant of credit, nor as an inducement therefor; and, in addition, that similar insurance not necessarily naming the lending institution as beneficiary may be obtained from independent agents or in lieu thereof existing insurance owned by the debtor may be assigned to the bank.

Recommended Decision:

(1) That the application be granted with respect to proprietary and employee insurance for First National Holding Company and its subsidiaries and for credit life, health and accident, and mortgage redemption insurance for their customers, but denied as to all other forms of insurance in the Atlanta, Ga. area.

(2) That the application be granted as to insurance agency sales by First South Insurance Agency division of Tharpe and Brooks, Inc. at its offices located outside of the Atlanta, Ga. area to customers of non-banking affiliates of First National Holding Company also located outside of the Atlanta, Ga. area subject to the restrictions as set forth in Regulation Y, Sec. 225.4(a)(9).

(3) That in those respects in which the application is granted, the authorization be subject to appropriate anti-coercion statements to be furnished for execution by customers as part of their insurance applications.

/s/ Paul N. Pfeiffer
PAUL N. PFEIFFER
Administrative Law Judge

DECIDED: January 14, 1974

APPENDIX I

Statutes and Regulations

Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1843(c)(8)(1970):

(c) The prohibitions in this section shall not apply to any bank holding company which is (i) a labor, agricultural, or horticultural organization and which is exempt from taxation under section 501 of Title 26, or (ii) a company covered in 1970 more than 85 per centum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors; and such prohibitions shall not, with respect to any other bank holding company, apply to—

• • • •

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders

and regulations under this subsection, the Board may differentiate between activities commenced *de novo* and activivities commenced by acquisition, in whole or in part, of a going concern; . . .

Section 7 of the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1846 (1970):

The enactment by the Congress of this chapter shall not be construed as preventing any State from exercising such powers and jurisdiction which it now has or may hereafter have with respect to banks, bank holding companies, and subsidiaries thereof.

Section 9 of the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1848 (1970):

Any party aggrieved by an order of the Board under this chapter may obtain a review of such order in the United States Court of Appeals within any circuit wherein such party has its principal place of business or in the Court of Appeals in the District of Columbia, by filing in the court, within thirty days after the entry of the Board's order, a petition praying that the order of the Board be set aside. A copy of such petition shall be forthwith transmitted to the Board by the clerk of the court, and thereupon the Board shall file in the court the record made before the Board, as provided in section 2112 of Title 28. Upon the filing of such petition the court shall have jurisdiction to affirm, set aside, or modify the order of the Board and to require the Board to take such action with regard to the matter under review as the court deems proper. The findings of the Board as to the facts, if supported by substantial evidence, shall be conclusive.

Section 225.4(a)(9) of Regulation Y, 12 C.F.R. § 225.4 (a)(9) 1977):

(a) Activities closely related to banking or managing or controlling banks. In accordance with the procedures set forth in paragraphs (b) and (c) of this section, any bank holding company may engage, or retain or acquire an interest in a company that engages, solely in one or more of the activities specified below, including such incidental activities as are necessary to carry on the activities so specified. Any bank holding company that is of the opinion that other activities in the circumstances surrounding a particular case are closely related to banking or managing or controlling banks may file an application in accordance with the procedures set forth in paragraph (b)(2) of this section. As to such an application, the Board will publish in the Federal Register a notice of opportunity for hearing only if it believes that there is a reasonable basis for the holding company's opinion. The following activities have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto:

* * * *

(9) acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:

(i) Any insurance for the holding company and its subsidiaries;

(ii) Any insurance that (*a*) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (*b*) is directly related to the provision of other financial

services by a bank or such a bank-related firm, or (*c*) is otherwise sold as a matter of convenience to the purchaser, so long as the premium income from sales within this subdivision (ii) (*c*) does not constitute a significant portion of the aggregate insurance premium income of the holding company from insurance sold pursuant to this subdivision (ii);

(iii) Any insurance sold in a community that (*a*) has a population not exceeding 5,000, or (*b*) the holding company demonstrates has inadequate insurance agency facilities.

No. 77-668

Supreme Court, U. S.
FILED
FEB 15 1978
MICHAEL RODAK, JR., CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1977

ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

WADE H. MCCREE, JR.,
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In the Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-668

ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., ET AL., PETITIONERS

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-53a) is reported at 533 F. 2d 224. The first opinion on rehearing (Pet. App. 55a-57a) is not reported. The second opinion on rehearing (Pet. App. 59a-60a) is reported at 558 F. 2d 729. The opinions of the Board of Governors of the Federal Reserve System (Pet. App. 63a-98a) are reported at 1974 Fed. Res. Bull. 596, 39 Fed. Reg. 25548, and 1974 Fed. Res. Bull. 738, 39 Fed. Reg. 33411.

JURISDICTION

The judgment of the court of appeals (Pet. App. 61a-62a) was entered on June 10, 1976. Petitions for rehearing

were granted in part and denied in part on January 10, 1977 (Pet. App. 55a-57a). A further order revoking part of the January 10 alteration of the initial judgment was filed on September 1, 1977 (Pet. App. 59a-60a). The petition for a writ of certiorari was filed on November 10, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether the Federal Reserve Board properly determined that the sale of insurance in connection with extensions of credit is "closely related" to banking, within the meaning of Section 4(c)(8) of the Bank Holding Company Act.

2. Whether the Board correctly applied the "public benefits" test of Section 4(c)(8) in determining that the public benefits expected from proposals for the sale of credit-related insurance outweighed any expected adverse effects.

STATUTE AND REGULATION INVOLVED

1. Section 4(c)(8) of the Bank Holding Company Act of 1956, as amended, 84 Stat. 1765, 12 U.S.C. 1843(c)(8), provides that a bank holding company may acquire:

> shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains

> in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. * * *

2. Section 225.4(a)(9) of Federal Reserve Board Regulation Y, 12 C.F.R. 225.4(a)(9), provides that activities closely related to banking or managing or controlling banks include:

> acting as insurance agent or broker in offices at which the holding company or its subsidiaries are otherwise engaged in business (or in an office adjacent thereto) with respect to the following types of insurance:
>
> * * * * *
>
> (ii) Any insurance that (*a*) is directly related to an extension of credit by a bank or a bank-related firm of the kind described in this regulation, or (*b*) is directly related to the provision of other financial services by a bank or such a bank-related firm * * *.
>
> * * * * *

STATEMENT

Section 4(c)(8) of the Bank Holding Company Act authorizes the Federal Reserve Board to approve applications by a bank holding company to engage in certain nonbank activities that are "so closely related to banking or managing or controlling banks as to be a proper incident thereto." Section 4(c)(8) thus calls for the Board to determine whether a proposed activity is "closely related" to banking and whether the performance of the proposed activity by the subsidiary of a particular bank holding company would be a "proper incident" to

banking by producing benefits to the public that outweigh its possible adverse effects.[1]

In 1972 Southern Bancorporation of Birmingham, Alabama, and First National Holding Corporation of Atlanta, Georgia, sought approval to write or sell property damage and liability insurance when the insurance was related to extensions of credit. Petitioners, various organizations and insurance agents, opposed the applications. An administrative law judge conducted extensive hearings on the applications and issued separate opinions recommending limited approval of each application (Pet. App. 99a-140a). The Board then reviewed the administrative record and determined that property damage and liability insurance sales directly related to an extension of credit are proper under 12 C.F.R. 225.4(a)(9)(ii)(*a*), and that the public interest favored approval of the proposals (Pet. App. 63a-98a).

The court of appeals sustained Section 225.4(a)(ii)(*a*) and (*b*) on its face (Pet. App. 22a)[2] and held that the Board properly applied its regulation to permit property damage and liability insurance sales that are related to extensions of credit (*id.* at 30a-34a). The court also concluded that the Board had correctly applied the "public benefits" test of Section 4(c)(8) and that substantial evidence supported the Board's determination that the expected public benefits of the proposed credit-

[1]The Board has determined by regulation that a number of specified activities are "closely related" to banking within the meaning of Section 4(c)(8). See 12 C.F.R. 225.4(a).

[2]The court struck down certain provisions of 12 C.F.R. 225.4(a)(9) that are not in issue here (Pet. App. 30a).

related insurance activities outweigh their possible adverse effects (Pet. App. 34a-48a).[3]

ARGUMENT

Petitioners' principal contention (Pet. 12) is that the courts of appeals do not agree on the meaning of Section 4(c)(8) of the Bank Holding Company Act. Petitioners are wrong.[4] The Board's decisions, and that of the court of appeals here, are supported by both the text and the legislative history of the governing statute, and there is no reason for review by this Court.

1. The court of appeals concluded that an activity is "closely related" to banking at least when it is tied to extensions of credit, when banks are particularly well situated to provide the service, or when banks traditionally have provided the service (see Pet. App. 23a-24a). Banks often have provided insurance services, and, acting under the predecessor to Section 4(c)(8), the Board had allowed banks to sell property damage and liability insurance and to engage in insurance sales of a more general nature.[5] The court of appeals, in canvassing the

[3]The court characterized the contest over these applications as a "commercial tug-of-war" between bank holding companies and the insurance industry and thought it best to "leave further struggle between insurance agents and these holding companies in specified areas to the marketplace" (Pet. App. 2a).

[4]"The Board's two-tier test * * * has been adopted and endorsed by every Circuit to consider the question." *Association of Bank Travel Bureaus, Inc.* v. *Board of Governors*, C.A. 7, No. 76-1186, decided January 12, 1978, slip op. 4.

[5]See, *e.g.*, *Otto Bremer Co.*, 1967 Fed. Res. Bull. 1555; *United Virginia Bancshares, Inc.*, 1970 Fed. Res. Bull. 599.

legislative history of Section 4(c)(8), demonstrated that it was not meant to prohibit any practice that was permissible under prior law (see Pet. App. 16a-21a), and the amendments to the statute consequently ratify, or at a minimum do not call into question, the Board's prior conclusion that the sale of some types of insurance is "closely related" to banking.[6]

The insurance at issue here is "closely related" to banking under any reasonable standard. The subsidiaries of the bank holding companies offer insurance pertaining to loans made by the bank and nonbank subsidiaries. One type of insurance would cover damage to the assets that secure the bank's loan; the Board and the court of appeals held that "banks have a legitimate *need* for physical damage insurance to protect the value of the collateral" (Pet. App. 31a; emphasis in original). The other type of insurance would cover the borrowers' liability for accidents associated with the collateral; the Board and the court of appeals found that "[l]iability insurance protects the borrower's ability to repay a loan, which would otherwise be destroyed by an accident or other catastrophe" (*id.* at 32a). The court of appeals also observed that borrowers find it desirable to obtain liability and property damage insurance as part of a package, and that the package as a whole not only arises out of the lending transaction but also protects the borrower's ability to repay (*id.* at 32a-33a).

---

[6]See S. Rep. No. 91-1084, 91st Cong., 2d Sess. 15 (1970):

> [T]hese [insurance agency] activities are "functionally related to banking" and are included under the new provision adopted by the committee to the full extent they were permitted under the existing act, and to such additional extent as the Board may find it desirable under the new criteria established.

These considerations demonstrate that, whatever may be the case with other types of insurance—and the court of appeals did not approve every type of insurance involved in this case (see Pet. App. 24a-30a)—property damage and liability insurance are "closely related" to banking. Petitioners contend, however, that the court of appeals' treatment of the "closely related" standard conflicts with *National Courier Association* v. *Board of Governors*, 516 F. 2d 1229 (C.A. D.C.).

National Courier specified three criteria for identifying activities as "closely related" to banking within the meaning of Section 4(c)(8). The court indicated in the present case that it was "willing * * * to consider broader types of relationships" (Pet. App. 24a), but this does not create a conflict because the *National Courier* court never purported to exhaust the categories of "closely related" activities. Indeed, the court in *National Courier* prefaced its listing with the caveat that "*at least* the following seem to us within the statutory intent" (516 F. 2d at 1237; emphasis added). The willingness of the court here to "consider" other possibilities therefore cannot amount to the creation of a conflicting legal rule.

Nevertheless, petitioners argue (Pet. 11, 13) that "the court of appeals articulated a standard * * * almost without limitations" by stating that "the Board should be upheld when it articulates any type connection between banking and the nonbanking activity in question which makes it rational to consider the proposed activity an 'incident' to banking" (Pet. App. 31a). But the determination whether an activity is "closely related" to banking was explicitly committed by Congress in Section 4(c)(8) to the judgment of the Board. The court of appeals' statement merely acknowledges that courts should defer to interpretations of a statute by the agency charged with

its administration. See, *e.g.*, *Udall* v. *Tallman*, 380 U.S. 1, 16. The *National Courier* court acknowledged the same governing principle (516 F. 2d at 1237).

2. The Board found, and the court of appeals agreed, that the provision of insurance satisfied the "public benefits" test of the statute. The court questioned the Board's conclusion that the sale of insurance would provide the public with greater convenience or with greater efficiency (Pet. App. 34a-41a). It concluded, however, that because the banks would provide the insurance service by *de novo* expansion, they would increase the competition in the insurance market and provide benefits to the public in that way (*id.* at 41a-42a). It then considered and rejected petitioners' argument that allegedly detrimental consequences of the sale of insurance by banks would outweigh the public benefits (*id.* at 42a-48a).

a. Petitioners do not question the court of appeals' conclusion that an increase in competition is a public benefit entitled to weight under the statute. They contend, however, that the court of appeals did not examine the Board's "public benefits" finding in the same way that, they maintain (Pet. 14-15), two other courts of appeals would have done.

Petitioners rely on *American Bancorporation, Inc.* v. *Board of Governors*, 509 F. 2d 29, 38 (C.A. 8), and *Independent Bankers Association of Georgia* v. *Board of Governors*, 516 F. 2d 1206, 1222 (C.A. D.C.). These cases state that the Board must hold hearings and scrutinize carefully the banks' specific proposals. But the Board held extensive hearings on the applications in issue here; petitioners participated in the administrative process that generated a record exceeding 3,000 pages and opinions that required 76 pages to reprint. The court of appeals

adopted the standard of the two cases on which petitioners rely, holding that only if there is a "fairly specific proposal * * * can the public interests recognized by Congress * * * receive realistic protection from the Board and the courts" (Pet. App. 49a-50a). It is difficult to understand, therefore, in what respect petitioners believe a conflict exists. The court of appeals simply applied the usual principles of administrative law to the facts of this case in determining that the proposals were sufficiently specific, and the hearings were sufficiently thorough, to withstand scrutiny.

b. Petitioners argue (Pet. 16) that the court of appeals, having found that two of the three grounds on which the Board relied in finding a public benefit were inadequate, should have remanded the case to the Board for further proceedings. But the court of appeals did not find that the Board's decision lacked support in the record, and neither the Board nor any court has concluded that the Board must find that more than one public benefit pertains to a particular proposal. Because the court of appeals found that none of the claimed adverse effects was reasonably likely to occur (Pet. App. 42a-48a), there would have been no point in remanding the case to the Board. A remand would have been appropriate only if the court had found that an adverse consequence was likely, and it then would have been necessary for the Board to weigh the benefits and detriments involved. Because no adverse consequence is likely, however, there is no weighing to be done. The court's conclusion that at least one public benefit is likely to occur is sufficient to sustain the Board's order.

c. Petitioners present a number of other contentions (Pet. 16-20), which reflect their disagreement with the Board's factual conclusions and its application of state law. These contentions do not implicate disputed legal

principles and do not call for review. See *Mobil Oil Corp. v. Federal Power Commission*, 417 U.S. 283, 310.

First, petitioners argue (Pet. 16-17) that one of the applications to the Board would involve a violation of Alabama law. There is no reason for this Court to pass on questions of state law (*Bishop* v. *Wood*, 426 U.S. 341, 346). The court of appeals recognized that Alabama law would not permit a bank to operate with only one licensed insurance agent in each state, but it properly observed that the applicant "repeatedly assured the Board that it would abide by all applicable [state] licensing requirements" (Pet. App. 51a). There is no reason for the Board to assume that the applicant will not keep this promise.

Second, petitioners contend (Pet. 18-19) that the court of appeals erred in stating that there is "no unexplained conflict" (Pet. App. 41a) between the Board's conclusions and the administrative law judge's findings. But the court was correct. The Board and the administrative law judge agreed that the provision of insurance would increase competition (see Pet. App. 75a, 92a-93a, 135a-136a); they disagreed only concerning the possibility that "voluntary tying" would occur. As to this possibility, however, the court held that the Board's decision is supported by substantial evidence (Pet. App. 46a), and its disagreement with the administrative law judge is not "unexplained."

Third, petitioners argue (Pet. 20) that substantial evidence does not support the Board's conclusion that the Alabama application would produce additional competition. But the court of appeals relied on evidence in the record demonstrating that the proposal would create pressure for lower prices and that the customer-attracting advantages of one-stop shopping for loans and insurance would increase service competition (Pet. App. 24a, 42a).

This gave the Board ample reason to approve the application.[7]

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1978.

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[7]Petitioners' contention that the Board violated its own regulations (Pet. 17) was not presented in the court of appeals, and it is too late for petitioners to raise the argument now. In any event, it is based on the incorrect assumption that 12 C.F.R. 225.4(a)(9) makes the price at which insurance is offered the overriding consideration in the Board's public benefit determination. Nothing in the language of the regulation supports that conclusion or purports to alter the statutory listing in Section 4(c)(8) of the Act of factors to be balanced in making the public interest determination. Indeed, the regulation to which petitioners refer identifies only activities that are "closely related" to banking; it is irrelevant to the Board's separate "public benefit" determination.

DOJ-1978-02

Supreme Court, U. S.
FILED
DEC 8 1977
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1977

No. 77-668

ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., ET AL.,

Petitioners,

versus

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Respondent.

BRIEF FOR INTERVENOR, FIRST NATIONAL HOLDING CORP., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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IN THE

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ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., ET AL.,

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Respondent.

BRIEF FOR INTERVENOR, FIRST NATIONAL HOLDING CORP., IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The pertinent opinions rendered below have been duly set out in the Appendices to Petitioners' Petition for Certiorari.

JURISDICTION

No consideration under Rule 19 of this Court governing review on certiorari exists in this case which would give this Court jurisdiction under its own rules.

QUESTIONS PRESENTED

Whether a writ of certiorari should be granted where the petitioners allege (presumably) that review should be had under the rules of this Court because the decision below was in conflict with decisions of other Courts of Appeals, or that the Court below has decided a federal question in conflict with applicable decisions of this Court, or in conflict with applicable State law but where the petition for certiorari, when pierced, fails to show any grounds for such allegations?

STATUTES INVOLVED

The pertinent statutes involved are properly set forth in the Appendices of the petition for certiorari.

STATEMENT OF THE CASE

Intervenor accepts the general statement (but not the conclusions and shadings drawn by petitioners therefrom) put forth by petitioners.

ARGUMENT

I.

The Petition for Certiorari Fails to Set Forth Any Grounds for Certiorari Under Rule 19 Of This Court and, In Particular, Fails to Show Any Conflict in the Decision of the Court Below Regarding the "Closely Related" Test As Applied by Courts of Appeals of Any Circuit.

Petitioners strive mightily to bring their case within the "conflict of circuits" portion of Rule 19, asserting boldly that this is a case of "first impression". Except to

the extent any new set of facts presented by a given case would be a "first impression" as to those facts, there are no issues of law presented by this case that have not been well settled by prior decisions, either of this Court or of competent inferior courts, including, among others, the very decision relied on by petitioners in their petition. Petitioners assert that the decision of the lower court in the case involved, with respect to the "closely related" test of the 1970 Amendments to the Bank Holding Company Act[1] (the "Act"), is directly in conflict with the decision of the United States Court of Appeals for the District of Columbia Circuit in the *National Courier* case cited in petitioners' brief (516 F.2d 1229). As a matter of fact, the two cases are almost 'mirror image" consistent; indeed, the lower court in the case at bar cited with approval and applied the *National Courier* decision in its own decision.

National Courier involved a portion of Regulation Y of the Federal Reserve Board (the "Board") issued pursuant to §4(c)(8) of the Act, which regulation approved as "closely related to banking," activities of a holding company relating to certain courier and transportation services for (i) the internal operation of the holding company, (ii) checks and instruments exchanged among banks and banking instrumentalities, (iii) audit and accounting media of a banking and financial nature and related business records and (iv) courier services for nonfinancially related material upon the unsolicitated request of third parties where other courier services were not available.

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[1] Appendix I of Petitioners' brief

By comparison, in the case involved, the Board in its Regulation Y sought to authorize as "closely related to banking" bank holding company activities as insurance agents or brokers for (i) insurance for the holding company and its subsidiaries, (ii) insurance directly related to an extension of credit by a bank or bank-related firm or that was directly related to the provision of other financial services by such, (iii) insurance sold as a matter of convenience to the purchaser under certain limitations, and (iv) insurance sold in a community which has a population not exceeding 5,000 or where insurance agency facilities were inadequate.

In *National Courier*, the Court of Appeals asserted (as did our Court below) that the Board must "articulate the ways in which banking activities and opposing activities are assertedly connected" and must find that the connections are close. The Court said at page 1237:

> "... at *least*, the following seem to us within the statutory intent:
>
> "1. Banks generally have in fact provided the proposed services.
>
> "2. Banks generally provide services that are operationally or functionally so similar to the proposed services as to equip them particularly well to provide the proposed service.
>
> "3. Banks generally provide services that are so integrally related to the proposed services as to require their provision in a specialized form." (Emphasis added.)

The Court in *National Courier* found all but the last of the above-stated courier activities passed the "closely related" test. However, it felt that the provision of non-financially related incidental courier services was justified by the Board only because it would serve someone's convenience and not because they were "closely related to banking" and held that the services authorized in this last category were, therefore, not validly permissible under the Act.

Likewise, in our case, the lower Court found that most of the insurance activities authorized by the Board in its Regulation Y were indeed "closely related to banking," but struck down not one (as in *National Courier*) but three of the insurance activities originally permitted by the Board in its regulation. Thus, the Court found (i) that that portion of §(a)(9)(i)[2] of the Regulation which authorized the sale of insurance for a bank holding company and its nonbank subsidiaries must be invalidated since they were not "closely related to banking," (ii) that §(9)(ii)(c) of the same Regulation, which purported to authorize "convenience insurance sales", was too broad for the same reason, and (iii) insurance sales by bank holding companies in communities under 5,000 were merely for the "convenience" of the public and not in any way related to banking.

In arriving at its decision, the Court below relied upon, and frequently quoted, *National Courier*. Both Courts came to almost identical conclusions for approximately the same reason. Both Courts emphasized the Board's broad powers and the discretion of the Board under applicable principles of administrative law[3]. Both Courts recognized the limited role of a court in reviewing the Board's regulation[4].

---

[2] Appendix I of Petitioners' brief, p. 143a

[3] 516 F.2d at 1237; Appendix A, pp. 19a, 21a and 31a of Petitioners' Brief.

[4] 516 F.2d at 1235; Appendix A, p. 21a of Petitioners' Brief.

Possibly, petitioner's contention rests on its perceived conclusion that the Court below in this case, after recognizing the three "closely related" tests set forth in *National Courier*, applied them to bar insurance for the holding company and its *nonbanking* subsidiaries but refused to apply the tests to bar insurance sold to *bank* subsidiaries. Petitioner has misread the *National Courier* tests, which were not, and were not intended to be, exclusive. To quote the *National Courier* court, "at least" these three elements should be in the test. The Court in our case, while recognizing and citing the three tests, was "willing . . . to consider broader types of relationships". There is nothing inconsistent in *National Courier* and *Alabama Association* on the question of "closely related to banking".

Incidentally, Petitioner's statement on page 13 of its brief that the *National Courier* test was applied and rejected by the Court below with respect to the "sale of property and casualty insurance", in general, is ambiguous. The Court was ruling there only on the sale of such insurance *to* banking subsidiaries, and was not discussing the proposition of sales of property and casualty insurance such as might be related to credit *by* the holding company or its subsidiaries, which authorization rests on entirely different grounds.

II.

The Petition Likewise Fails to Show Any Conflict in the Decision of the Court Below Regarding the "Public Benefits" Test As Applied by Courts of Appeals of Any Circuit.[5]

Petitioners cite *American Bancorporation*[6] decided in the Eighth Circuit and *Independent Bankers*[7] de-

[5] Appendix I, Petitioners' Brief, p. 141a.
[6] 509 F.2d 29.
[7] 516 F.2d 1206.

cided by the United States Court of Appeals for the District of Columbia Circuit as being in conflict with the decision of the Court below as to the application of the "public benefits" test of §4(c)(8). Both the *American Bancorporation* and the *Independent Bankers* cases merely held that the protestants were entitled to a full hearing on the specific aspects of their respective applications which would bear on the "public benefits" required by the statute. Of course, in our case, extensive hearings were, in fact, held at which petitioners appeared, presented numerous witnesses and conducted extensive cross examination. Even so, the deficiencies in this area asserted by the petitioners relate solely to the case of the other Intervenor (Southern Bancorporation) and not to First National's case. We assert, however, the soundness of the Court's deference to the judgment of the Board in weighing the various competing interests involved, in light of the Board's long expertise. Nevertheless, Petitioner's brief fails to show any conflict whatsoever in the circuits on this issue.

III.

The Court Was Correct in Not Remanding the Case to the Board, Since the Decision of the Board was Supported by Substantial Evidence Even After the Decision of the Court of Appeals.

The petitioners insist that the court below should have remanded the matter to the Board for a rebalancing of public benefits against adverse effects on the public interest, since the Court has ruled that two of the three "benefits" were not supported by sufficient evidence. Intervenor would point out, first, that the three "benefits" mentioned in the statute were not exclusive or mandatory, but were suggested,

by use of the words "such as", as typical of what the Board should look for. Nevertheless, even considering these three factors alone, the Court found one favorable factor remaining, and no adverse effects on the public interest. It held:

> "In summary, we find that the Board's conclusions with respect to efficiency gains and greater convenience are not supported by substantial evidence, but that its other findings are. Accordingly, the Board properly found one type of public benefit, in the form of increased competition, and no adverse effects on the public interest. The Board's overall finding, that public benefits outweigh adverse effects of granting the applications, can therefore be upheld."

This is, of course, the "substantial evidence" rule of administrative law as set forth in the leading case of *Universal Camera Corp. v. National Labor Relations Board,* 340 U.S. 474, 71 S.Ct. 456 (1951). In that case, Mr. Justice Frankfurter held that a reviewing court should not disturb an agency decision if there is substantial support for the decision in the record, and he made it clear that a reviewing court should consider the record as a whole in determining whether there was substantial support and should not focus on isolated portions of the record. This general rule has remained essentially unchanged to this date and it is entirely applicable here.

The *Chenery* case and the *Third National Bank* case cited by the petitioners (page 16, petitioners' Brief) are not in point. *Chenery,* of course, is a landmark case in the administrative law field but does not deal with the point at issue here. In fact this Court there held that if the SEC had promulgated a general rule (as the

Board has here) and adopted an order of which the matter at issue was a particular application, the situation would be different. In *Third National,* the remand was to a court, not an agency, and even then, because the court had applied the wrong rule and not because of insufficient evidence.

Intervenor submits that the correct rule here is that of *Universal Camera* to the effect that the entire record as a whole must be considered in a search for substantial support and that the Court below, having done so, quite properly let stand the Board's decision. *See also, Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.,* 419 U.S. 281, 95 S.Ct. 438 (1974).

Furthermore, the courts have held not only that the ruling of an agency in its field of expertise must be upheld if supported by substantial evidence (*see, Northwest Bancorporation v. Board of Governors of the Federal Reserve System,* 303 F.2d 832 (8th Cir. 1962) but also, that the responsibility to assess the record to determine whether agency findings are supported by substantial evidence is not that of this Court but of the Court of Appeals. *Mobil Oil Corp. v. FPC,* 417 U.S. 283, 94 S.Ct. 2328 (1974).

IV.

The Other Assertions of the Petitioners Supporting Their Claim of a Right to Certiorari Are Either Not Applicable to Intervenor or Are Without Merit.

The claim of the petitioners that approval of the instant application would transgress state law, even if valid, would affect only the Intervenor, Southern

Bancorporation. The other points are simply without merit. There is nothing in the record to indicate that the applicants will not make every effort to obtain insurance for the customers at the lowest practical cost. Any other policy would not make good competitive sense, nor is there any merit in the claim that the court ignored the record. The Board, and not its Administrative Law Judge, has the ultimate responsibility to exercise its expertise in coming to appropriate conclusions on the basis of the record. Intervenor has already discussed the "substantial evidence" rule in an earlier section and will not repeat it here.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned attorney for the Intervenor, First National Holding Corp., hereby certifies that copies of the foregoing Brief for Intervenor, First National Holding Corp., in Opposition to Petition for Writ of Certiorari have been served upon counsel for the other parties by mailing three (3) copies, postage prepaid, to the following:

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Supreme Court, U. S.
FILED
FEB 16 1978
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-668

ALABAMA ASSOCIATION OF INSURANCE AGENTS, INC., *et al.*,
Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITIONERS' REPLY TO BRIEF FOR RESPONDENT IN OPPOSITION

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WILSON · EPES PRINTING CO., INC. · RE 7-6002 · WASHINGTON, D. C. 20001

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Petitioners, the Independent Insurance Agents of America, Inc., its constituent state associations and various individual member agencies in the States of Alabama and Georgia, hereby reply to the brief in opposition for the respondent Board of Governors of the Federal Reserve System ("Board").

I. REBUTTAL OF BOARD ARGUMENTS

A. *Violation of the Board's Regulation.* The Board's allegation that the petitioners' contention that the Board

violated its own regulation was not presented to the court of appeals is *false*.[1] In fact, petitioners argued the point in their reply briefs to the court of appeals and again in their petition for rehearing.[2] In 1971 the Board determined specifically that it is the *fiduciary responsibility* of an insurance agency applicant to offer insurance to the public at the *lowest practicable price*.[3] The Board cannot now be heard to argue that an applicant's failure to meet this fiduciary responsibility "is irrelevant to the Board's . . . 'public benefit' determination." [4]

B. *Conflicts with Other Courts of Appeals—Application of the "Public Benefits" Test.* The Board's brief is not responsive to petitioners' contention that the decision below fundamentally conflicts with previous holdings of other courts of appeals regarding the proper application of the "public benefits" test.[5] Either Section 4(c)(8) requires applicants to make specific showings of how they intend to operate their proposed nonbanking activities, or it does not. The courts of appeals for the Eighth and the District of Columbia Circuits have said that it does; the court of appeals below has ruled that it does not.[6] This Court should resolve that fundamental conflict.

C. *Arrogation of Decision Making.* As the Board concedes in its brief,[7] the court of appeals struck down the Board's findings regarding *two out of three* of the "public

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[1] Respondent's Brief, at 11 n.7.

[2] *See* Petitioners' Alabama Reply Brief, at 17-18 (filed June 6, 1975); Petitioners' Georgia Reply Brief, at 18-19 (filed June 6, 1975); Petitioners' Petition for Rehearing, at 10-11 (filed July 8, 1976).

[3] *See* 36 Fed. Reg. 15,525, 15,526 (1971); Petition, at 17.

[4] *See* Petition, at 17. *But see* Respondent's Brief, at 11 n.7.

[5] Respondent's Brief, at 8-9.

[6] *See* Petition, at 14-15.

[7] Respondent's Brief, at 9.

benefits" factors of the overall test—greater convenience and gains in efficiency.[8] More than that, however, the court specifically recognized that the record evidence suggested that the applicants' proposals would actually result in *less convenience* and *reduced efficiency*[9]—both of which would obviously adversely affect borrowers who choose to purchase their insurance through the applicants' agencies.[10] Given these adverse effects,[11] under the logic of the Board's own brief, the court of appeals should have set aside the Board's orders.[12]

D. *Violation of State Law.* The Board in its brief now argues that "[t]he court of appeals recognized that Alabama law would not permit a bank to operate with only one licensed insurance agent in [the] state . . . ." [13] The point is, however, that the Board specifically found that the Alabama applicant "will initially have but one licensed agent at the head office of its lead bank . . . ." [14] In other words, the Board approved an application which it now concedes was in clear violation of state law. Once again, the logic of the Board's own brief shows that the court of

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[8] Petition Appendix A, at 37a-41a.

[9] *Id.* It should also be emphasized that, with respect to increased competition—the only remaining public benefits factor of the test—the court characterized the supporting evidence as "vague." *Id.* at 41a-42a. *See* note 18 and accompanying text *infra*.

[10] *See* Petition, at 16, 17-18, 20.

[11] Furthermore, given Congress's concern, the Board's previous pronouncements and the Administrative Law Judge's categorical findings regarding the possibility of decreased competition as a result of "voluntary tying," the Board's rejection of the "voluntary tying" issue in the context of these cases is not credible. *See* Petition, at 10 n.28, 19 n.65.

[12] In addition, the factual predicate for a finding of increased competition is destroyed. *See* notes 18-23 and accompanying text *infra*.

[13] Respondent's Brief, at 10.

[14] Petition Appendix E, at 74a.

appeals should have set aside the Board's order relating to that applicant.

E. *Conflict with the Administrative Law Judge.* The Board's contention that its finding of increased competition was consistent with the recommendation of the Administrative Law Judge below is misleading.[15] While the Administrative Law Judge did find that approval of the application in question would increase the quantity of competition in the short term,[16] that finding must be read in conjunction with his ultimate conclusion that the quality of the competition would be destructive to independent agents and, in the end, would result in *decreased* competition.[17]

F. *Substantial Evidence.* The only evidence supporting the Board's public benefits findings was characterized by the court of appeals as "vague." [18] Furthermore, the court's reference, in the context of increased competition, to "pressure for lower prices" and "customer-attracting advantages of one-stop shopping" [19] renders the court's decision internally contradictory in light of its earlier recognition that approval of the applications might actually result in "efficiency loss" [20] through the "negative efficiency effects of non-use of direct billing," [21] and a

[15] *See* Respondent's Brief, at 10. *But see* Petition, at 18-19.

[16] At the place cited by the Board for authority, the Administrative Law Judge states that "[a]pproval of the application would probably result in additional *units* of insurance agency competition but there is no proof that such would result in savings to customers in the form of lower premiums." Petition Appendix H, at 135a (emphasis added).

[17] Petition Appendix H, at 138a-39a.

[18] *See* Petition, at 20. *See also* note 9, *supra*. *But see* Respondent's Brief, at 10.

[19] Petition Appendix, at 41a.

[20] *Id.* at 40a.

[21] *Id.* at 41a.

"decrease in convenience" [22] as a result of the remoteness of applicants' agents from consumers. Accordingly, the factual predicate which must underlie any finding of increased competition was not present in these cases, and consumers are left to pay *higher* prices for insurance under circumstances of *reduced* convenience.[23]

G. *Conflicts with Other Courts of Appeals—"Closely Related" Test.* The Board concedes that the "closely related to banking" standard adopted by the court of appeals in the instant cases is broader than was applied by at least one other court of appeals.[24] Furthermore, the Board's argument ignores the fact that, unlike in the case of insurance sold in connection with "extensions of credit," the court approved the sale of insurance which is "directly related to the provision of other financial services" [25] without any discussion as to why it sustained that portion of the regulation.

II. CONSEQUENCES OF A FAILURE TO GRANT A PETITION

Denial of the instant petition would leave standing a court of appeals decision which holds that Section 4(c)(8) of the Act permits the Board to approve nonbanking applications even though (i) the manner in which the proposed activities will be conducted is not explained,[26] (ii) the Board makes assumptions—not supported by the rec-

[22] Petition Appendix A, at 38a.

[23] *See* Petition, at 17-18.

[24] *See* Respondent's Brief, at 7. *But see* Petition, at 12-13. Further, the Board tries to sustain part of its argument by reference to a Senate Report supporting the "functionally related to banking" standard which was rejected when the legislation was ultimately enacted. *See* Respondent's Brief, at 6 n.6.

[25] *See* Petition Appendix I, at 143a-44a.

[26] Petition, at 15.

ord—as to how the applicants will conduct those activities,[27] and (iii) the Board violates its own regulations which makes the provision of nonbanking services at the lowest practicable price to consumers a *fiduciary responsibility* of such applicants.[28] Each of the foregoing deficiencies is a fundamental violation of the Act.

Denial of the instant petition would invite massive entry by bank holding companies into the retail property and casualty insurance industry under circumstances which even the court of appeals recognized might adversely affect consumers.[29] Even worse, the rulings below so emasculate the standards of Section 4(c)(8) of the Act that prospective opponents of bank holding company entry into *any* nonbanking activities—faced with virtually certain defeat—can be expected to forego the enormously expensive litigation associated with Section 4(c)(8) oppositions. This chilling effect may well remove from the province of the courts the review function contemplated by Section 9 of the Act.[30] The continued vitality of the historical separation between banking and commerce in

[27] *Id.* at 17.

[28] *Id.* at 17-18.

[29] *See* notes 18-23 and accompanying text *supra*.

[30] 12 U.S.C. § 1848 (1970).

this nation—a separation the Congress clearly sought to perpetuate through the Act[31]—will become the exclusive domain of the Federal Reserve Board.

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[31] Petition, at 5 n.11.